S. HRG. 104–862

# MERGERS AND COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY

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## HEARING

BEFORE THE

## COMMITTEE ON THE JUDICIARY
## UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

ON

EXAMINING RECENT DEVELOPMENTS IN THE TELECOMMUNICATIONS INDUSTRY, FOCUSING ON THE STATE OF COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY AND THE APPLICATION OF ANTITRUST LAWS WITH REGARD TO CERTAIN MERGERS

SEPTEMBER 11, 1996

**Serial No. J–104–95**

Printed for the use of the Committee on the Judiciary

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# MERGERS AND COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY

**WEDNESDAY, SEPTEMBER 11, 1996**

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The committee met, pursuant to notice, at 2:08 p.m., in room SD–G50, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee), presiding.

Also present: Senators Thurmond, Simpson, Grassley, Leahy, and Feingold.

## OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

The CHAIRMAN. Good afternoon. I would like to thank our distinguished panelists for joining us today for what I believe to be an illuminating and lively discussion and examination of recent developments in the telecommunications industry. Telecommunications are a very basic, vital element of our daily lives, and at the same time represent one of the most dynamic and exciting arenas of American business today.

From its very earliest days, telecommunications technology has literally revolutionized the way we lead our lives and conduct our business. Imagine how different our lives would be were we unable to telephone our families or fax documents to business associates.

At the same time, we are today on the threshold, if not in the midst of what can truly be considered a revolution in the telecommunications industry. Moreover, this pace of technological change is matched by a breathtaking transformation in the competitive landscape of the telecommunications industry. In the wake of the Telecommunications Act of 1996, which promises to unleash previously constrained competitive forces in the telecommunications industry, we read every day of new entrants into the telecommunications field, new joint ventures, mergers, and other business combinations which are working to reshape the whole telecommunications industry.

Perhaps the most noteworthy of the developments since the passage of the Telecommunications Act is the emergence of mergers between Bell Atlantic and NYNEX, SBC and Pacific Telesis, and WorldCom and MFS. All of these developments, of course, contribute to a radically changing, competitive environment, and I believe it is important for this committee to exercise its antitrust oversight function to keep abreast of the transformations taking place in the telecommunications industry and to explore how the antitrust laws

should properly be applied in this emerging new telecommunications age.

Today's hearing is an important first step in exercising this oversight function. By examining these three mergers, with my primary interest being their ramifications under antitrust law as well as their implications for consumers and for competition generally, this committee will gain a vivid snapshot of what is happening in the telecommunications field and, I hope, obtain further insight on the proper application of the antitrust laws in this context.

While, of course, these mergers should and will be reviewed by the Department of Justice for a proper assessment under the antitrust laws, I should point out that mergers are not in and of themselves anticompetitive. In an era where we are seeing increasing globalization of telecommunications services, and in particular the emergence of large global companies and alliances, mergers of domestic telecommunications firms may well help American companies remain competitive in this international arena.

Moreover, mergers may contribute significant cost savings and may play an important role in the trend toward combined services or, "one-stop shopping," for telecommunications services. All indications are that we will see more and more major telecommunications providers offering a full spectrum of services, including not just local and long distance, but video, cable, and information service technologies as well.

Indeed, just today I read in the Wall Street Journal that AT&T, which many might think of as just a long distance company, has won what is reported to be the largest out-sourcing contract to manage a corporation's information services. This trend toward providing a broad range of telecommunications services under one roof, of course, will greatly benefit consumers and will in many instances depend on mergers or other business combinations. In developing world markets, where domestic firms must compete, big is not necessarily bad when it comes to domestic mergers. Indeed, we will hear testimony today which may prove that certain mergers can, in fact, enhance competition.

I believe that our hearing today will shed light on these and other issues, and I want to thank the distinguished panelists who have taken time from their busy schedules to join us. We will introduce our first panel of witnesses in just a minute, but let me just turn to Senator Leahy for any remarks he has for the minority.

## STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator LEAHY. Thank you, Mr. Chairman. One of the self-proclaimed achievements of the Congress was the new telecommunications law. It was voted for by an awful lot of people in both parties and it was going to unleash the benefits of competition. I voted against the bill. I didn't believe that it would come up with that much competition.

I said the day it passed on the floor that "Mega-mergers between telecommunications giants, such as the rumored merger between NYNEX and Bell Atlantic or the gigantic network mergers now underway, raise obvious concerns about concentrating control in a few gigantic companies of both the content and means of distributing

the information and entertainment American consumers receive. Competition, not concentration, is the surest way to assure lower prices and greater choices for consumers. Rigorous oversight and enforcement by our antitrust agencies is more important than ever to ensure that such mega-mergers do not harm consumers." I said that then.

Now, so far—and I realize that the law is somewhat new, but the new telecommunications law has produced little competition in local phone service or between players that have traditionally acted in different segments of the industry. Outside of the Bell companies and GTE, independent phone companies still account for, I believe, less than 1 percent of the total market for local phone service. Competition from the cable companies for telephone service has not arisen, although that is not surprising. It has been my experience cable companies much prefer monopolies because it is easier to gouge the consumers than competition.

The new technologies have yet to provide an effective competitive check on prices or to pressure improved services. Instead of this kind of competition, we have seen in the months since the law passed massive consolidation within the telecommunications industry. Within only 2 months of the bill's passage, four of among the biggest companies in this industry announced that they would not compete; instead, they would merge. Instead of seeing new entrants into every market, we are seeing old monopolies getting bigger and expanding their reach.

As we are going to confirm today, concentration of ownership in the telecommunications industry is currently proceeding faster than the pace of competition. So my questions will be focused on trying to understand how these mergers are good for competition and for consumers. Perhaps they are. So far, those answers have escaped me, but I assume that somebody will enlighten me.

When I wrote Chairman Thurmond back in April urging that we convene an antitrust hearing into mergers in telecommunications, that was my concern. I wanted to know why the companies involved feel that bigger is better. I wanted to know why the companies involved chose to merge rather than to compete.

The determination whether these mergers will go forward, and on what conditions, is a matter before the Department of Justice, which has the expertise to scrutinize this. One of the provisions we were able to preserve in the new Telecommunications Act was a very strong savings clause that continues to require that telecommunications mergers be reviewed in conjunction with our Federal antitrust laws.

The two mergers between the Bell companies will concentrate almost 45 percent of all local phone lines in the country in the hands of just two companies. They will affect not only the millions of people who depend on the companies involved for an increasing array of advanced telecommunications services but also, of course, competition in the entire industry.

I know that when I am at my farm in Middlesex, VT, or I am at my office here in the District of Columbia, or whether I am at the home I use during the session in Virginia, I still have only one choice for dial tone and local telephone service. That choice—well, actually, I have two choices. I have the choice of the Bell operating

company or no service at all. The current mantra of the industry seems to be one-stop shopping, but if that one stop is at a monopoly that is not competing on price and service, I don't think it is the kind of one-stop shopping that consumers want.

I am concerned that the distraction of these huge mergers will complicate and delay the companies' compliance with their new obligations to open up their networks. That would not be good for competition in the local loop. I know that the Bell companies, the FCC, and the State regulatory agencies are in an area of transition and there is a lot of work to be done. But I am concerned that consolidation, Mr. Chairman, is taking precedence over competition and may create additional barriers to effective competition.

We have three different mergers before us today. About the only thing they have in common, of course, is the number of zeroes in the value of the deals. They are all huge, they are all in the billions. What happens to NYNEX is very important to Vermont. It is one of the major employers in my State and provides most of the phone service to our State. I want to know where Vermont is going to fit in the priorities of a much bigger company. What does that mean for jobs, services, and telephone rates for Vermonters?

But I also, Mr. Chairman—and this has to be a concern of yours and of Chairman Thurmond's—what do these things mean for rural areas? You have large rural areas in your States, as I do in mine. I know we are going to hear testimony that these mergers will generate operational efficiency and cost savings. That is a good thing, but local phone service is not competitive yet. We want to make sure the savings are passed on to ratepayers. Ratepayers are also important, not just the corporate officers and shareholders.

Mr. Chairman, I am glad we are having this hearing. As I said, I may have overlooked as we went along some of the benefits of such mergers, but I am sure if they are present, they will come out at these hearings.

Thank you.

The CHAIRMAN. Thank you, Senator Leahy. Because of a wide variety of conflicts, I can't be here throughout the whole hearing and will only be here for a short period, but our chairman of the Antitrust Subcommittee is Senator Thurmond and he will chair the hearing as soon as I leave. We are going to hear from him at this time, since he has such a vital role in this matter.

Senator Thurmond.

## STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Thank you, Mr. Chairman, I want to thank you for proceeding with this hearing, despite obstacles and unavoidable delays. As chairman of the Antitrust Subcommittee, I am pleased that you view this hearing as significant enough to merit the attention of the full committee.

Fostering vigorous competition in the telecommunications industry through application of antitrust principles remains an important issue facing our Nation and deserves our attention. This is a time of rapid change, and even large telecommunications companies worry about their continued health and survival.

The purpose of this hearing is to examine how competition is developing in telephone services following enactment of the Telecommunications Act by considering the three large pending mergers involving telephone services. Two of the mergers involve so-called Baby Bells. Last April, SBC Communications and Pacific Telesis stated their intent to merge. A similar announcement of Bell Atlantic and NYNEX quickly followed. These firms are four of the seven regional Bell operating companies created by the break-up of the Bell System in 1984 to provide local phone service in separate regions of the country.

Each of these four Bell companies already enjoys a dominant market position in local exchange services in its region, so the mergers will not increase their market shares, but simply result in much larger companies. Of course, the mergers will eliminate any chance of the merging pair competing with each other in the future, and some assert that these consolidations may make it more difficult for others to offer competing local phone services.

The third merger represented here today is between WorldCom, the fourth largest long distance company, and MFS, which provides local access service to business customers in many cities. This merger, announced just 2 weeks ago, has generated interest because of the potential of the combined company to provide end-to-end service to customers. The ability to offer a full range of telephone services from one source has been the driving strategy of many large telephone companies in recent years.

These mergers are important because of the trend they may set or the pressure they may place on other companies to consolidate and become larger in order to be competitive. The role of the Congress is to oversee implementation of the Telecommunications Act to ensure that vigorous competition develops in areas where it has been unable to flourish in the past, particularly in local telephone service. However, it should be emphasized——

The CHAIRMAN. We have a vote on. I am sorry to interrupt Senator Thurmond, but I will go vote and Senator Thurmond will finish his statement. As soon as he is finished, we will recess until we can get back.

Senator THURMOND [presiding]. However, it should be emphasized that we are not here to determine the lawfulness of these pending mergers under the antitrust laws. That task is entrusted to the Antitrust Division of the Department of Justice. Under the applicable antitrust standard in Section 7 of the Clayton Act, the mergers can be modified or blocked only if their effect may be, "substantially to lessen competition." Open investigations into the Bell mergers prevent the Justice Department from sending a witness to testify today. However, Deputy Assistant Attorney General David Turetsky has submitted a short written statement for inclusion in the record.

Also I would like to enter into the record the statement of Senator Simon.

[The prepared statements of Senator Simon and Mr. Turetsky follow:]

PREPARED STATEMENT OF SENATOR PAUL SIMON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

When the telecommunications legislation became law earlier this year, its promise was to provide consumers with more choices, better service and lower prices. I voted against the legislation at the time because I didn't feel that it would achieve these important goals. I still don't.

I commend the Chairman for holding hearings on mergers in the telephone-based telecommunications sector, but we should also examine the effects of the 1996 Act in another segment of the industry: radio broadcasting.

One of the many problems with the new law is its complete elimination of national radio ownership limits and tremendous relaxation of local radio station ownership limits. Its provisions run contrary to the intent of the Communications Law of 1934, which was based, in part, on the fundamental principle that the public owns the airwaves. The 1934 Act allows the FCC to grant broadcast station licenses only if it finds that doing so will further the "public interest, convenience and necessity." While this principle and this requirement do not mean that radio broadcasting cannot be run as a for-profit business, they do mean that these licenses are not a right, but a privilege. One of the duties that should continue to accompany that privilege is to serve the public interest of the community. The 1996 Act cuts radio programming loose from the moorings of the public interest and potentially sets it adrift in a sea of nationally homogenized programming that serves only the interest of big corporate radio owners in search of advertising dollars.

In less than two weeks after enactment of the 1996 Act, almost $1.4 billion in radio properties changed hands. By July there had been $5.2 billion in radio deals. In the July 8, 1996 Investment Dealers Digest, Joseph Zimmel of Goldman, Sachs & Company said of the deals, "[t]hey want more outlets in the same market so they have a more powerful story to offer advertisers." A more powerful story to offer advertisers? That says it all.

Group station owners argued that the prior to the 1996 Act, ownership caps stifled radio's ability to grow and its ability to draw a profitable share of advertising revenues. But the likely effect of the relaxation of the limits is echoed in the words of an American Radio Systems Company executive David Pearlman who said in the February 5, 1996 Broadcasting & Cable magazine, all companies will have to make the decision whether to get big or get out."

Two of the companies moving to get even bigger are Westinghouse and Infinity, which with their proposed merger, would own 83 radio stations—69 of which are in the top markets—with combined revenue of $1 billion dollars and eight percent of the radio industry's total advertising revenue. This deal would not have been possible without the station ownership changes made in the Act.

In the first edition of Ben Bagdikian's "Media Monopoly" (1983), he documented the rapid increase in concentration of media ownership by national and multinational corporations that "control what America sees, hears and reads." At that time, 50 corporations earned more than half of all revenues derived from the dissemination of information. In the most recent edition of Mr. Bagdikian's book (1992), he found there were just 20 firms that earned more than half of such revenues.

This increased concentration raised the obvious concern about diversity in broadcasting, a hallmark of the radio industry. As the companies "get big" programming tends to get more generic. As stated by Robert Unmacht, the editor of the radio industry newsletter, the M Street Journal, "I feel sorry for the listeners * * * finding a creative and interesting radio station will be harder because the pressure is on to make them very much alike." For instance, since 1994, five of New York's FM stations switched their format to modern rock. An Infinity-owned station, WXRK, was a classic rock station until earlier this year when it too switched to a modern rock format.

When a company owns many stations in one market, it can offer package advertising deals to that smaller owners can't offer. They can also cross-promote their stations. The end result is that they will have the power to force smaller owners out of business. That will leave listeners with fewer voices, less diversity and, probably, less localism.

Last month, the Justice Department approved the $774 million merger of radio group owners Jacor and Citicasters Inc. This merger, along with other pending mergers involving Jacor, would give it 51 stations in 15 major markets. The Department ruled, however, that Jacor could not maintain the 53% share of advertising dollars it would have acquired in Cincinnati and ordered them to divest down to a 50% share. The Department believed that without the divestiture, Jacor would

have eliminated all of the competition between the stations and advertisers would have been forced to pay higher rates.

It is my hope that as the Justice Department continues its review of these radio mergers for their anti-competitive effect, that, to the extent appropriate, it will also consider the direct effect on the listening audiences.

I am a cosponsor of legislation to restore the radio ownership caps in place prior to passage of the Act. The bill is now pending in the Commerce Committee. Through I am realistic about the odds of this legislation moving this year, I am hopeful that there will be a legislative fix at some point in the near future. While restoring ownership caps to their previous limits will correct only one of the bill's many flaws, it is certainly a step in the right direction.

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PREPARED STATEMENT OF DAVID TURETSKY, DEPUTY ASSISTANT ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE

The Department of Justice appreciates the opportunity to share its perspective on the outlook for competition in the telecommunications industry, and the Department's crucial role in preserving competition in the telecommunications industry, in the wake of enactment of the Telecommunications Reform Act of 1996.

Competition is clearly the first guiding principle and the immediate objective of the new law. By removing a number of legal and regulatory obstacles to competition, the new law makes more competition possible. We need to ensure that such potential is realized by ensuring that anticompetitive conduct and combinations do not set up new roadblocks. The changes in the law, the regulatory framework and the other changes in the industry, particularly changes in technology, make antitrust enforcement not only more challenging, but also even more important.

The mission of the Antitrust Division and the antitrust laws in the new and changing world of telecommunications is the same as our mission has always been—protecting and promoting competition. Keeping markets free and open has always been the mission of the Antitrust Division, and it is a mission which has always enjoyed strong bipartisan support. The Antitrust Division has a tremendous record of achievement in the telecommunications area, including fostering competition through the break-up of AT&T in 1984. Since that action, prices to consumers for long-distance, manufacturing, and information services have dramatically declined and innovation has been spurred. This more competitive environment has positioned our nation's telecommunications sector to successfully compete throughout the world.

I will give particular emphasis in this statement to our merger enforcement work, as an unprecedented wave of telecommunications mergers has been occurring since the passage of the Act and is expected to continue. Of course, we will also be enforcing the Sherman Act against restraints of trade or illegal monopolization of any telecommunications market, as well as consulting with the FCC regarding applications by the Bell companies to enter the long distance business, in accordance with section 271 of the new law. But merger enforcement promises to be a major focus of our telecommunications work in the foreseeable future. We will need to devote a significant portion of our resources to this task.

MERGER ENFORCEMENT

The Antitrust Division reviews proposed mergers under section 7 of the Clayton Act for their possible anticompetitive effects. The new Telecommunications Act not only preserved this important role, but also expanded it by eliminating section 221(a) of the Communications Act of 1934 which immunized mergers between telephone companies from antitrust review if approved by the FCC. We are grateful to the members of this Committee who recognized that section 221(a) was not in keeping with the competitive market basis of the Telecommunications Reform Act and successfully worked to remove it.

The new law has spawned an unprecedented wave of telecommunications industry mergers, acquisitions, and joint ventures, including among some of the largest and most prominent firms in the industry. Not only has the total volume of our workload substantially increased, but, because of the new possibilities presented by the new law, the telecommunications-related mergers that are occurring are different and more complex than previous mergers in this industry. As a result, we need to devote virtually unprecedented resources to reviewing the competitive aspects of these corporate unions. Nevertheless, with continued congressional support, I am confident we will continue to be able to fully protect competition and consumers from anticompetitive results.

Many of the mergers are said to be taking place in preparation for changes in the marketplace expected to result from enactment of the new law. Others are mergers

that were legally precluded before enactment—such as by regulatory limitations on the number of radio stations a single firm can own.

Of course, I am not at liberty to comment specifically on any of the proposed mergers that may be currently under review by the Antitrust Division. But citing a few indicia of this merger wave that have been reported publicly in the press during the past couple of months helps show its significance.

According to press reports, the three announced proposed mergers involving Bell operating companies alone have a combined estimated value of $48 billion. There are also mergers between non-Bell Operating Companies that provide telephone service that have been proposed. The potential competitive consequences from all of these mergers must be fully assessed, and we are in the middle of these reviews right now.

The changes discussed above have also spurred numerous TV and radio station acquisitions. According to press reports, thus far this year alone, TV station acquisitions have totaled an estimated $7 billion in value. Radio station acquisition deals announced this year, 189 in number, have totaled an estimated $25.6 billion in value. We have already filed one case, Jacor Communications, in which we alleged that a radio station acquisition violated section 7 of the Clayton Act, and currently we are reviewing several other proposed acquisitions raising competitive issues.

And this is only the beginning. The new law is barely seven months old. The regulations to implement it are just beginning to be finalized.

All this is taking place against the backdrop of record merger activity throughout our economy. According to recent press reports, last year set a merger record at $502 billion total value. And as of a month ago, this year's rate was out-pacing last year's rate by almost 15 percent.

We intend to be vigilant in performing our merger enforcement responsibilities, and we appreciate the continued support of Congress. The Antitrust Division will be closely monitoring transactions in the telecommunications industry—as we must. Developments in the communication of information will not only have a profound and immediate impact on virtually all consumers, but will likely be the catalyst for innovation and productivity growth in the economy well into the next century.

Sound and reasoned merger enforcement is needed to ensure that competition continues and grows as telecommunications markets are restructured. Competitive markets are crucial for maximizing the development of innovative technologies and services and for providing consumers with the widest possible range of choices at the lowest possible prices. So it is crucial to prevent mergers that would dampen the competitive impulse or that would limit market access by competitors. Consequently, we will be subjecting proposed mergers in the telecommunications industry to the full rigorous scrutiny required by law. And, if there is significant evidence that a merger is likely to result in competitive harm, we will challenge it, and we will structure our proposed remedy to prevent that harm.

CONCLUSION

The world of telecommunications is changing dramatically. Passage of the new law ushers in a challenge to shift the fundamental paradigm from regulation to competition as the core of our telecommunications policy. That is a shift that we in the Antitrust Division welcome and will continue to support and encourage.

As the regulatory moorings that have held the structure of this industry in place for the better part of a century are being cut, there will be many new business opportunities, and ultimately new products, services, and combinations that perhaps even the most visionary among us may not yet foresee. The job of antitrust enforces in the face of such dramatic change is to safeguard the competitive marketplace that will enable these positive developments to unfold. That will make the new law's promise a reality, and maximize the resulting benefits for consumers and our economy.

Senator THURMOND. It is instructive to note that the purpose of our antitrust laws is not to favor one group over another, but to utilize objective principles to encourage competition for the benefit of consumers. Proper application of antitrust principles ensures that competition flourishes and that Americans enjoy the highest quality goods and services at the best possible prices. If antitrust principles are neglected, however, competition is likely to suffer and we risk avoidable concentration of market power, leading to in-

flated prices, less innovation, and erosion of our Nation's competitive standing.

Our antitrust laws shield American markets from economic distortions by fostering healthy competition, so that companies rise or fall on their merits rather than through abuse of market power and other anticompetitive practices. In short, antitrust law is both proconsumer and probusiness.

The Telecommunications Act of 1996, which we passed in February, is one of the few pieces of legislation that can truly be described as "landmark." Under the vigorous leadership of Senator Pressler, chairman of the Commerce Committee, our Nation's basic communications law was overhauled for the first time in 60 years, while ensuring that mergers like those being discussed today remain fully subject to our antitrust laws.

Senator Pressler has correctly stated that the intent of the act is to achieve lower prices and better services through more competition, less Government regulation, and the broader operation of market forces. The fundamental reason for this hearing, and the challenge before us, is to ensure that the promise of the Telecommunications Act is realized for the benefit of consumers. In this regard, when the Bell mergers were announced I personally called in the CEO's to express concern that local rates for consumers should not increase.

The ultimate impact of the Telecommunications Act depends on its implementation in the marketplace. While the act and its regulations are intended to produce vigorous and sustained competition for the benefit of American consumers, achievement of this goal can only be measured in the real world. As the marketplace responds to the act and other developments, significant changes in the shape and composition of the telecommunications industry are inevitable.

In addition to the three mergers we are examining today in the area of telephone services, many other large telecommunications mergers are occurring in cable, radio, and other areas. This trend of mergers, joint ventures, and other business alliances is certain to continue in the future. At the same time, the telecommunications industry is swelling with large numbers of new entrants. While it is impossible to predict the future, I look forward to hearing the views and best estimates of our witnesses today about the development of the telecommunications world over the next few years.

As our Nation is a free-market economy, the Government should not block or resist the reorganization of firms seeking better ways to provide services to consumers unless such moves are anticompetitive. In many cases, mergers will be procompetitive, resulting in efficiencies and better services at lower prices for consumers, and the application of antitrust principles by the antitrust enforcement agencies should so reveal.

Although mergers between dominant parties routinely receive tough antitrust scrutiny, mergers between smaller players are not likely to face problems under the antitrust laws. For example, the proposed merger between WorldCom and MFS appears likely to create a more effective but nondominant competitor which, to my knowledge, has not raised any antitrust concerns.

Less than a year-and-a-half ago, I chaired a hearing on antitrust issues in the pending telecommunications bill. Remarkable progress has been made since that time, but we must not sit back and view our work as complete. This is a vital period which will determine whether widespread competition can be achieved in local telephone services. Until healthy competition arrives in all telecommunications markets, consumers will not reap the full benefits of the Telecommunications Act.

I want to thank each of the witnesses for their time and effort in appearing before the committee this afternoon, and expect that they will be very informative.

Now, we will stand in recess until the chairman returns. At that time when we take up the witnesses we will allow 5 minutes for each witness. They can put their entire statements in the record, but we have so many witnesses, we have to limit them to 5 minutes.

[Recess.]

The CHAIRMAN. Our first panel of witnesses today are executives from telecommunications firms who have announced mergers. First, we will hear from Mr. James Young, who has been vice president and general counsel for Bell Atlantic Corp. since 1992. After Mr. Young, the committee will hear from Mr. James Ellis, who has been the senior executive vice president and general counsel for SBC Communications since 1989, and Mr. Bernard J. Ebbers, president of LDDS WorldCom, will finish the first panel. Mr. Ebbers has been president of LDDS WorldCom since 1985.

Now, let me just announce that the second panel consists of three more industry executives. Mr. Michael Salsbury is executive vice president and general counsel for MCI Communications. William Barr is before us today as senior vice president and general counsel for GTE Corp. Mr. Barr, of course, is a former attorney general and is a familiar face to many around here, so we welcome you back to the committee, General Barr. Mr. Robert Atkinson, senior vice president for legal, regulatory and external affairs for Teleport Communications Group in Staten Island, NY, will finish up that distinguished panel.

Then in our final panel today, we will hear from four distinguished telecommunications experts. First up will be Mr. Peter Huber, a senior fellow from the Manhattan Institute. He is an expert in telecommunications markets and antitrust policy. Mr. Robert Crandall is a senior fellow at the Brookings Institution here in Washington, DC. He brings us expertise in telecommunications regulation.

Mr. Ronald Binz is president and policy director of the Competition Policy Institute. He is an expert on competition policy and consumer issues in the telecommunications industry. Mr. Dale Hatfield is the chief executive officer of Hatfield Associates and he will be the final witness today. Mr. Hatfield also brings us expertise in telecommunications policy.

So I would like to thank all of these distinguished witnesses for taking time to be with us today. Because we have so many witnesses testifying, I would ask that each of you—Senator Thurmond undoubtedly already has—limit your testimony to 5 minutes per witness. We will put all statements in the record as though they

were fully delivered, and if you can summarize in 5 minutes, we would appreciate it. The red light means you should quit as soon as that comes on.

So we will turn first, then, to Mr. Young.

**PANEL CONSISTING OF JAMES R. YOUNG, VICE PRESIDENT AND GENERAL COUNSEL, BELL ATLANTIC CORP., ARLINGTON, VA; JAMES D. ELLIS, SENIOR EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, SBC COMMUNICATIONS, INC., SAN ANTONIO, TX; AND BERNARD J. EBBERS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, LDDS WORLDCOM, JACKSON, MS**

**STATEMENT OF JAMES R. YOUNG**

Mr. YOUNG. Good morning, Mr. Chairman. My name is James Young and I am general counsel of Bell Atlantic. I would like to thank you and the committee for the opportunity to appear before you this afternoon because I would like to take Senator Leahy up on his offer. I want to have the chance to explain to you why our merger is procompetitive, why it is good for consumers, why it is good for employees.

I would like to touch first, if I could, in my remarks, here on the fact that the new Bell Atlantic will be a good competitor. I want to focus first on a point that Senator Leahy raised. As required by the Telecommunications Act of 1996, we will continue to open our network to facilitate competition in the local services businesses.

It may not be evident to members of the committee, but a lot of the hard work of implementing the Telecommunications Act is going forward. We have negotiated a number of interconnection agreements. We are providing unbundled network elements, as the act requires. A lot has gone on. It may not be visible, but the act is working.

In addition, though, and maybe even more important, we intend to fulfill the promise of the act by bringing competition to the domestic long distance market, a market that has been dominated by a cartel for the last several years. We expect that the combined Bell Atlantic-NYNEX will be a better competitor than either of the individual companies would have been alone.

We also will be a strong competitor for cable. Consumers want choice in cable and we are determined to provide that choice, and as well in the emerging market for Internet and Internet access services. In these areas, consumers will see more choices, better prices. We are also committed to good service. With competition coming to our business the way the Telecom Act of 1996 dictates, we don't have any other choice.

One brief note on the reasons behind the merger. I don't think it comes as any secret to the members of this committee that today the telecommunications marketplace is dominated by very large companies. Individual companies such as AT&T, Nippon Telephone and Telegraph, Deutsche Telekom are all larger than our new merged company will be. In fact, even after its divestiture, AT&T will be twice the size of the merged Bell Atlantic-NYNEX.

Now, these giant companies are, over and above their initial size, forming into even larger alliances to compete in the telecommuni-

cations marketplace. There is the AT&T-led World Partners. There is MCI's lash-up with British Telecom. There is the Global One organization that consists of Sprint, France Telecom, and Deutsche Telekom. These aren't ephemeral alliances; they are very permanent arrangements. British Telecom has poured billions into MCI. The European partners have poured billions into Sprint. These are very permanent arrangements.

These companies are very logical challengers for the new Bell Atlantic and we are a very logical company to provide more competition to them. Indeed, AT&T has recently announced that, with the Telecom Act of 1996, they believe they will have 35 percent of the local exchange market in this country in a matter of only a few years.

Mr. Chairman, as you pointed out, this committee is concerned with antitrust issues. In my testimony, I have attempted to deal with what I think is one of the principal antitrust issues raised about the merger, and that is, Would Bell Atlantic and NYNEX have competed with each other if not for the merger? I have attempted to deal with this in detail in my written testimony. Let me just make a couple of points.

First, as Senator Thurmond noted, we are today—we do not compete with NYNEX. We are not in the same markets and we have no plans to compete with each other. So there is absolutely no overlap between the two companies.

Second, as I noted, the Telecommunications Act is working. There is a large number of companies that are eager to get into my local exchange markets and that are eager to get into NYNEX' local exchange markets. Even in Vermont, for example, Hyperion has negotiated an interconnection agreement to provide local exchange service. So there is plenty of competition.

If I could summarize my views on this merger in just one thought, it would be this. A year ago, Bell Atlantic and NYNEX put together their cellular companies to provide better service to customers. Now, a year later, by merging those two companies, we are providing better service at better rates, and in terms of jobs the new combined company has more jobs than either of the two companies did before. By putting together Bell Atlantic and NYNEX, the telephone companies, we are going to do the same thing.

Thank you, Mr. Chairman.

The CHAIRMAN. Is that more jobs in both of the two companies than before? Is that what you meant to say?

Mr. YOUNG. Yes.

[The prepared statement of Mr. Young follows:]

PREPARED STATEMENT OF JAMES R. YOUNG

Good morning, Mr. Chairman and members of the Committee. My name is James Young, and I am General Counsel of Bell Atlantic Corporation. After the merger, I will be General Counsel of the new Bell Atlantic.

I want to thank you for the opportunity to appear before this Committee today to discuss this merger. In my testimony, I would like to show you that consumers stand to benefit from the greater competition and innovation that the merged company will be able to bring to the telecommunications marketplace, both in this country and worldwide.

This merger is the result of the astounding changes that have occurred in the telecommunications industry in recent years. The Information Age is here, brought

to us by the technological advances we read about every day, either in old-fashioned newspapers or in e-zines on the Net.

Technology has changed the legal and regulatory paradigms in this industry. There are no more exclusive franchises, for cable or telephone companies. No one is guaranteed a "fair rate of return." Markets are truly global, not local. These changes offer us opportunities to expand beyond our traditional businesses. At the same time, they offer others, often firms or alliances with resources greater than ours, the chance to go after the business that we have long counted on.

The territories served by Bell Atlantic and NYNEX are among the most attractive for these competitors to attack. And this competition is well underway from some of the worlds' largest companies, including AT&T, SBC, Time Warner and the combination of British Telecom and MCI. AT&T alone has said that it will take one-third of the local service business. We need to match their resources and their skill if we are to succeed.

## REGULATORY STATUS AND HISTORY

Before I turn to the benefits of the merger, let me tell you where we are in going through all the regulatory approvals that we need in order to consummate this merger. We made our Hart-Scott-Rodino filing on May 1, received a second request from the Department of Justice on May 31 and substantially complied with that request in July.

On July 3, we filed with the Federal Communications Commission applications to transfer various FCC licenses. The Commission has issued a public notice asking for comment on the applications later this month with replies due in late October.

At that same time, we filed papers with the state utility commissions in all 14 jurisdictions in which Bell Atlantic and NYNEX provide local service, advising them of our plans or, where required by State law, seeking their approval of the transaction. Three State commissions have already indicated that they have no need to look any further at the merger.

At this point, neither a State or federal regulatory agency, State antitrust or consumer protection authority, nor the Department of Justice has indicated that it will oppose or otherwise attempt to block the Bell Atlantic-NYNEX merger.

That is where we are today in the approval process. Now let me take us back a few years to the breakup of the Bell System in 1984, the court-approved divestiture that gave birth to both Bell Atlantic and NYNEX. At that time, there was nothing magical about there being seven Baby Bells. The MFJ neither required nor prohibited the consolidation of the ownership of the Bell companies into any particular number of entities. AT&T proposed to distribute its 20-plus local telephone companies among seven holding companies largely for administrative convenience. The Department of Justice agreed, and the court approved their plan.

This decision was not guided by antitrust concerns. In early 1982, before the decisions was made, the head of the Antitrust Division, Professor Baxter, told the Senate Commerce Committee that there might be any number of local Bell companies and that he "would not be greatly alarmed by a single operating company." If a single nationwide operating company posed no antitrust risk then, the combination of two of the seven holding companies surely can pose no risk now that all telecommunications markets are far more competitive.

## THE MERGER WILL BENEFIT THE PUBLIC

But that's enough of the past. Let's look at what will happen in the future. The new Bell Atlantic will be a strong company, well positioned to compete with the telecommunications giants of the world. Individual companies such as AT&T, Nippon Telephone and Telegraph and Deutsche Telekom are all larger than the merger company will be. Even after AT&T's divestiture, it will be twice as large as the new Bell Atlantic. These international giants are also teaming up into global alliances like the AT&T-lead World Partners, MCI's and British Telecom's Concert, and Global One of Sprint, France Telecom and Deutsche Telekom. These arrangements are not merely ephemeral alliances that will come and go. British Telecom has invested $4.3 billion in MCI in return for a 20 percent stake in the company, an ownership interest comparable to what France Telecom and Deutsche Telekom received in exchange for their $3.7 billion investment in Sprint.

The location of the new Bell Atlantic, serving both the political and financial capitals of the United States, makes the company a natural target of—and challenger to—these multinational powerhouses. Bell Atlantic and NYNEX customers make about 35 percent of the international calls from the United States, and we want to be able to begin to provide competition for these customers' business.

The new Bell Atlantic will be a good competitor at home. First, we will complete the opening up of our network to facilitate local service competition, as required by the Telecommunications Act of 1996. Although we may disagree with many aspects of the FCC's order implementing those provisions of the Act, we are moving ahead to comply with it. And at least as important, we intend to fulfill the promise of the Act by bringing competition to the domestic long distance market that has been dominated by AT&T, MCI and Sprint. We expect that the combined Bell Atlantic/NYNEX will be a better competitor than either company could have been on its own.

We also will be a strong competitor against the incumbent cable companies and in the emerging marketplace for Internet and Internet access services.

In all these areas, competition will bring consumers more options than they have today and hold down the lower prices they have to pay.

THE MERGER WILL NOT IMPEDE COMPETITION OR HARM THE PUBLIC

This merger will clearly not recreate the old Ma Bell, as some critics have suggested. While we will be a large company, we will not even be the largest telecommunications provider in the United States. We plainly will not remotely approach being the monolith that was the old AT&T, which dominated every facet of telecommunications, from equipment manufacturing to local service and long distance. We will be a new entrant, with virtually a zero market share of the interLATA long distance business. In our local markets, the merged company will begin its life as the largest provider, but the reforms required by the Telecommunications Act and State commission orders will cause us to face competition that the old Ma Bell never dreamed of. And because our competitors in this marketplace will be large, well financed companies such as AT&T and MCI, we will have a real fight on our hands—a fight which, I must add, consumers can only benefit from.

Nor will this merger eliminate or substantially reduce competition in any line of commerce. The combination of the two companies will still leave ample numbers of providers in every segment of the telecommunications marketplace.

For example, some argue that Bell Atlantic and NYNEX could have competed in each other's territories in offering local exchange services. There are already numerous firms competing or ready to compete for consumers' business—more than twenty competitive local exchange and access service providers in New York, and only a few less in New Jersey. Consumers in these states will have a wide range of good choices even without the separate participation of both Bell Atlantic and NYNEX.

While Bell Atlantic could have competed in New York State, we have no special advantage that would have caused us to enter the New York market in the absence of the merger. In this connection, it is important to remember that Bell Atlantic has been free to go into New York for the last ten years, and it has chosen not to do so.

Bell Atlantic would have no special advantage as a competitor in New York. Bell Atlantic has no facilities in New York and it could not readily use its facilities in New Jersey to compete on the other side of the Hudson River. In contrast, many other companies—including AT&T, MCI, Sprint, Time Warner, Teleport, and MFS—already have switches and transport facilities in place.

Bell Atlantic is contiguous with NYNEX only in the New York City area, as most of the area along the border between New York and Pennsylvania and New Jersey is served by unaffiliated telephone companies. The New York City area is already one of the most intensely competitive telecommunications markets in the country.

Unlike many other telecommunications service providers, Bell Atlantic has no customer base in New York, no network of sales offices or customer service centers. Other firms, especially those who have long engaged in national marketing efforts, have greater name recognition in New York than does Bell Atlantic, in spite of the geographic proximity.

I am not the only one who thinks that Bell Atlantic should not be considered a potential competitor in the local exchange business in New York—the FCC has reached the same conclusion. When the Commission recently waived certain pricing rules applicable to NYNEX because of the "increasingly competitive" character of the market in the New York City area, its discussion of current and expected competition did not even mention Bell Atlantic.[1]

This view of the marketplace is consistent with that held by others in Government. In discussion after discussion, including testimony before Congress, the Administration cited long distance carriers, cable operators, competitive access providers and wireless providers as the source of competition for the Bell companies.

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[1] *NYNEX Telephone Cos.*, 10 FCC Rcd 7445 (1995).

These analyses do not even mention other Bells as providing competition outside their existing territories.[2]

Nor will the merger impede in any way the ability of new entrants to come into our local markets. The framers of the Telecommunications Act did their job well in writing requirements for the opening up of local markets to competition. And by making this opening up a prerequisite for our getting interLATA authority from the FCC, they gave us every incentive to get on with the job and to get it done.

Some skeptics have suggested that the merger will cause our customer service to deteriorate. This is not so. We remain committed to providing all our customers the highest quality service possible. The new Bell Atlantic will draw on the best ideas of each company to improve overall service and customer satisfaction. If we are to succeed in the marketplace of tomorrow, we must provide good customer service.

This merger is not only good for consumers, it will also benefit our employees. The merger will not cause a single bargained-for employee to lose his or her job. Both companies will, of course, honor existing labor contracts. While we do expect to be able to consolidate a number of administrative and corporate functions, the Telecommunications Act opens up new opportunities for us and our employees to move into new areas. The senior management team is committed to acting responsibly to all our employees and will pursue redeployment of people whose jobs are affected by the merger.

Thank you.

The CHAIRMAN. Mr. Ellis.

## STATEMENT OF JAMES D. ELLIS

Mr. ELLIS. Mr. Chairman, I am Jim Ellis, representing Southwestern Bell, SBC Communications. I am delighted to be here to talk about our merger with Pacific Telesis, and also to comment briefly on the state of telecommunications competition.

With respect to the merger, I would say first of all that we believe very strongly that the combined company will be good for consumers, for our employees and for our shareholders. With respect to this combined company, it is going to be one that is going to be stronger financially. It is going to have better resources, it is going to have efficiencies, it is going to have scale, and it is going to have the management talent to compete against the very large competitors that are out there, the large national and multinational companies.

They are household names. Jim Young has just mentioned some of them, but certainly they are much larger than SBC and in some cases they are larger than the combined SBC and Pacific Telesis—names like AT&T and MCI and British Telecom, Time Warner, and I could go on. In addition to those, there are hundreds of other competitors already indicating that they intend to compete in California and in our five States where SBC operates today.

With respect to the antitrust issues, we feel very strongly that this merger is not anticompetitive. It is procompetitive. To put it in the Clayton Act terms that I believe Senator Thurmond talked about before, there is nothing about this merger that will substantially lessen competition. We are not competitors of Pacific Telesis and they are not our competitors today. Beyond that, we are not potential competitors of Pacific Telesis and they are not potential competitors of ours.

It is clear under the law you look at the plans of both companies. Our plans that preceded this merger by a long time show clearly

[2] E.g., Memorandum of the United States in Support of MFJ Modification to Permit Limited Trial of Interchange Service by Ameritech, *United States* v. *Western Elec. Co.* (D.D.C. 1995); Comments of United States Department of Justice at 36, FCC CC Dkt. 96–98 (May 16, 1996); Statement of Anne K. Bingaman Before the Senate Commerce Committee, March 3, 1995.

our intentions were not to compete with Pacific Telesis, and vice versa. Given that, there is nothing about this merger that will eliminate an actual competitor or a potential competitor. I would say further, even if we were potential competitors, which again we are not, there are substantially more competitors in this market than the three that the Justice Department guidelines look to.

Now, with respect to the issue of telecommunications competition, in general, I will try and be brief and simply point out, as the committee knows, that in January of 1996 the new Telecommunications Act was passed and the President signed it in February. That act had as its centerpiece the deregulation of telecommunications and the opening of all markets to all competitors. It was supposed to work on the basis of private negotiations under the auspices of the States. Where necessary, there would be mediation and, beyond mediation, arbitration, again under the auspices of the States to introduce competition across the local exchange markets.

The FCC released an order last month and it was anything but deregulatory. In fact, what the FCC has done is essentially preempted the State regulation of local exchange competition, something that for generations has been the subject of State jurisdiction. The FCC has come in and taken 8 or 9 pages of the statute and written an almost 700-page decision, with 3,200 footnotes—anything but deregulatory. Along the way, they have preempted the regulation authority of the States over local exchange. I am not talking long-distance; local exchange telephone service.

They have preempted private negotiations, and they have also set in place a pricing scheme that has the effect of subsidizing many of the large companies that I have just ticked off here, and at the same time confiscating the property of others. At a minimum, this decision has cast a cloud over the implementation of the Act. It has already prompted, not surprisingly, a lot of litigation. We have seen four or five appeals filed already, and I think, at best, it is going to create uncertainty. At worse, it is going to require expenditure of funds. Ultimately, we are going to have to start over, when I believe the commission's decision is going to be reversed.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Ellis. As I understand it, you are saying that neither of the merging companies here were competitors or were likely to become competitors.

Mr. ELLIS. That is correct, sir.

[The prepared statement of Mr. Ellis follows:]

PREPARED STATEMENT OF JAMES D. ELLIS

My name is James D. Ellis. I am the Senior Executive Vice President and General Counsel of SBC Communications Inc. ("SBC"). At the outset, I want to thank Senator Hatch and the members of this committee for their interest in the state of competition in the telecommunications industry, including the proposed merger of SBC and Pacific Telesis Group ("PacTel").[1]

My testimony is divided into two parts. In the first part, I will focus on the planned merger between SBC and PacTel. The merger raises no concerns under this nation's antitrust laws, and is in the interest of the customers, employees, and shareholders of both companies. The second part of my testimony will focus on the state of competition in the telecommunications industry.

[1] *Attachment 1* contains more information about SBC and PacTel.

## I. THE SBC/PACTEL MERGER

*A. Background information concerning the SBC/PacTel merger*

On April 1, 1996, SBC and Pacific Telesis Group announced that the two had agreed to merge into a single company to be known as SBC Communications Inc. The combined company will offer telecommunications products and services under the brand names of Southwestern Bell, Pacific Bell, Nevada Bell, and Cellular One.

The SBC/PacTel merger will combine two of the smallest regional Bell companies into a single company. The merger is designed to draw upon the strengths of both SBC and PacTel, in order to create a single company capable of more effectively meeting the challenge of the new competitive telecommunications environment. SBC has a proven track record in product development, in marketing and sales of telecommunications products and services, in providing wireless services, in revenue and net income growth, and in increasing shareholder value. PacTel is a leader in network integration, in the development of Internet access services, and in expense reduction and process management. The merged company will be better positioned to compete with such telecommunications giants as AT&T (and its merger partner McCaw), MCI (and its partner British Telecom), Sprint (and its partners France Telecom and Deutsche Telekom), TCI, Time Warner, and many others.

The merged company will also be better positioned to deliver greater benefits to customers, employees, and shareholders. Customers will benefit because the combination of the resources and strengths of both companies, including a sharing of start-up costs, will enable the merged company to offer a broader array of telecommunications products and services at competitive prices. Employees will benefit because the combined company will be a financially stronger and more effective competitor, resulting in the creation of new jobs and advancement opportunities in new lines of business. Shareholders will benefit because the combined company will have a more diversified, stronger financial base and be better positioned to succeed in growing the business and shareholder wealth.

The merger will require Department of Justice ("DOJ"), Federal Communications Commission ("FCC"), California Public Utilities Commission ("CPUC") and Nevada Public Service Commission ("Nevada PSC") review. The DOJ will review the merger under Section 7 of the Clayton Act. The FCC will have to review and approve the transfer of microwave, personal communications service ("PCS") and other licenses from PacTel to SBC. And finally, the CPUC and the Nevada PSC will review and approve the transfer of control in accordance with applicable state law.

*B. The Hart-Scott-Rodino merger review process*

On April 10, 1996, SBC and PacTel filed their pre-merger notification documents with the DOJ pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR"). Under the HSR procedures, the DOJ issued its "second request" for documents and information concerning the merger. SBC and PacTel have both completed their production of these materials, and the DOJ has advised the parties that they are in substantial compliance. This means that we are free to close the transaction as soon as other regulatory approvals are received. In the meantime, we are providing answers to the DOJ's few remaining questions. We hope that the DOJ will conclude its investigation in the very near future.

*C. This merger presents no antitrust concerns*

Under the applicable case law interpreting and applying Section 7 of the Clayton Act, the critical question is whether the proposed merger will result in a "reasonable likelihood" of a substantial lessening of competition.

SBC and PacTel are not actual competitors today. SBC and PacTel operate in entirely distinct and separate geographic areas of the country, and they do not compete in any relevant product market. Accordingly, this merger will have no adverse impact upon competition by eliminating an actual competitor.

Moreover, SBC and PacTel are not potential competitors. Each company plans to compete in the telecommunications marketplace by building upon their strengths in areas where they have network facilities in place, an existing customer base, and brand name recognition. This is true whether one is talking about local exchange and exchange access, long distance, wireless, video, or Internet access services. This means that absent the merger, SBC intended to compete only in its traditional five state region of Arkansas, Kansas, Missouri, Oklahoma, and Texas, and out-of-region where it provides cellular and cable television services. In the case of PacTel, it means California and Nevada. Consequently, under DOJ's Merger Guidelines, SBC and PacTel are not potential competitors now or in the near future.

In addition, there are many actual and potential competitors of both SBC and PacTel in their respective geographic and product markets, which only underscores that competition will not be diminished by this merger.[2]

II. THE STATE OF COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY

This portion of my testimony will briefly discuss SBC's view of the current state of competition in the telecommunications marketplace, with special emphasis on the long distance and local exchange marketplaces; of the Telecommunications Act of 1996 ("'96 Act"); and of the FCC's recent orders to implement the '96 Act.

*A. Competition before the Telecommunications Act of 1996*

Over the past twelve years, the United States has experienced some competition in both the long distance and the local exchange marketplaces. Historically, the biggest impediments to the development of competition have been both legal and regulatory barriers to entry. These legal and regulatory entry barriers at both the federal and state levels have imposed artificial restrictions on firms seeking to offer a package of both long distance, local exchange services, and other telecommunications services.[3] This has occurred despite the fact our market research tells us that customers are demanding one-stop shopping for all their telecommunications needs and one bill for the services they receive.

*1. The long distance marketplace*

In the case of the long distance marketplace, the legal barrier to entry by the regional Bell companies has insulated the interexchange carriers from significant competition and enabled them to keep their prices to the average consumer artificially high. Since 1984, the marketplace for interLATA long distance services has been dominated by three facilities-based carriers (AT&T, MCI, and Sprint), with some other smaller facilities-based carriers and hundreds of resellers providing the balance of the "competition." At the end of 1995, AT&T, MCI, and Sprint had a combined total market share of 81.8%.[4]

Market shares, however, do not tell the whole story. The interexchange marketplace is not characterized by the price competition that most consumers anticipated in 1984. Rather than engage in price competition, AT&T, Sprint, and MCI have engaged in what can best be described as "lock-step" pricing. The only competition which the average consumer sees from these interexchange carriers is in the form of advertising.

Since 1990, access charges—the charges which local exchange carriers assess interexchange carriers for originating and terminating long distance calls—have steadily gone down. At the same time, except for certain privileged customers who are able to take advantage of specific discount pricing packages, the basic rates AT&T, MCI, and Sprint have charged the remaining consumers for placing long distance calls have steadily gone up in "lock-step."[5] James M. Buchanan, winner of the 1986 Nobel Prize in Economics, has concluded that "[p]ricing in the interLATA market now more closely resembles an oligopoly than the perfect competition envisioned a decade ago."[6] And Paul W. MacAvoy, former dean of the Yale School of Manage-

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[2] As of today, 51 firms have been granted authority to become local exchange carriers in SBC's region, and 65 such applications are pending. Similarly, as of June 1, 1996, 64 firms were granted authority to become local exchange carriers against PacTel in California, and 13 such applications were pending. These include interexchange carriers (such as AT&T and MCI), CAPs (such as MFS and TCG), adjacent local exchange carriers (such as GTE), cable television providers (such as Time Warner), and others.

[3] For example, the regional Bell operating companies were prohibited from providing interLATA long distance services in competition with the interexchange carriers by the Modification of Final Judgment. The '96 Act continues to temporarily prohibit the regional Bell companies from providing in-region interLATA long distance services. Interexchange carriers and others were largely prohibited by state law from providing local exchange services in competition with the incumbent franchised local exchange telephone companies.

[4] Table 6, Long Distance Market Shares: Fourth Quarter 1995, Industry Analysis Division, Common Carrier Bureau, FCC, March 1996.

[5] *Attachment 2* is a chart reflecting these access charge reductions and lock-step price increases as of January 1, 1994. This chart was attached to the Affidavit of Lester D. Taylor, Professor of Economics, University of Arizona, in support of the Motion Of Bell Atlantic Corporation, BellSouth Corporation, NYNEX Corporation, and Southwestern Bell Corporation To Vacate The Decree, *U.S.* v. *Western Electric Co.*, Civil Action No. 82–0192 (D.D.C. July 6, 1994) ("*Motion To Vacate*).

Since that time, AT&T, MCI, and Sprint have raised prices in lock-step on at least two more occasions. The lastest was early in 1996. AT&T proposed rate increases for basic residential long distance service and some business services on February 16, followed by Sprint on February 20, and MCI on February 21. These rate increases went into effect on one day's notice.

[6] Affidavit of James M. Buchanan at 6, in support of the *Motion To Vacate*.

ment, has written a book based upon his research and economic analysis of pricing in the long distance market which also confirms the existence of this phenomena.[7]

We believe that increased competition from regional Bell company entry into the in-region interLATA long distance market will benefit consumers.

*2. The local exchange marketplace*

Historically, local exchange service in this country has been provided by telephone companies which held franchises granted by the states. Under the terms of these franchises, the local exchange telephone companies were generally the only firms legally authorized to provide service in their certificated service territories. This grant of an exclusive franchise was based upon a belief among many economists that the provision of local exchange service was a natural monopoly.

In return for this exclusive franchise, the companies providing local exchange service were pervasively regulated by the state public service commissions in respect to the services which they offered the public, the prices they charged for those services, the capital investments they made, and the level of earnings they could receive on their investment. In addition, they had the obligation to serve all customers within their franchised service territories—that is, to provide universal service at artificially low rates regardless of actual costs. In order to support universal service, the pricing structure under which the franchised local exchange telephone companies provided their services was based upon numerous subsidies. Exchange access, long distance, and vertical services (e.g., speed dialing, call waiting, three-way calling, Caller ID, etc.) subsidize local services, business services subsidize residence services, and urban services subsidize rural services.

Despite these entry barriers, local exchange carriers like SBC have seen the development of some competition in the form of private networks, CAPs, interexchange carriers, and wireless.

Large customers such as businesses, office parks, hospitals, universities, and government entities have created private networks which completely bypass the franchised local exchange telephone company. Such private networks are used to switch calls within the network itself, and to deliver calls directly to the local exchange carriers, CAPs, and interexchange carriers.

CAPs—such as Metropolitan Fiber Systems, Inc. ("MFS") and Teleport Communications Group ("TCG")—have also emerged as a source of competition in the provision of exchange access services to interexchange carriers and other large customers. In the past five years, we have seen a proliferation of the CAPs which have deployed fiber optic rings in all major cities throughout the United States. Large customers can deliver traffic from their private networks directly to the CAPs for delivery to interexchange carriers and completely bypass all local exchange carrier facilities. Moreover, CAPs can and do purchase interexchange services from the interexchange carriers and resell those services in conjunction with their access services. Conversely, interexchange carriers can and do purchase access services from the CAPs and resell them in conjunction with their interexchange services. CAPs are prevalent in all of SBC's major markets and provide direct competition to Southwestern Bell Telephone Company ("SWBT").[8]

IntraLATA toll competition exists in each of SBC's five states. Since the prices SWBT charges consumers for intraLATA toll services include subsidies for basic residential services, interexchange competitors (such as AT&T, MCI, and Sprint) have made major inroads into this market.

Finally, wireless has also become a source of competition in the local exchange market. The cellular industry has seen phenomenal growth since its inception in 1984, when the FCC licensed two facilities-based cellular carriers in each market. It has provided some consumers with an alternative to placing calls over the landline local exchange network. Recently, the FCC has auctioned the licenses for the new wireless service known as PCS.[9] Thus, PCS will soon provide the local exchange industry with many new facilities-based competitors.

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[7] Paul W. MacAvoy, "The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Service," The MIT Press and The AEI Press (1996).

[8] *Attachment 3* shows the number of CAPs and the location of CAP networks in each of the five states served by SBC.

[9] There will be two 30 MHZ licenses in each of the 51 MTAs, and one 30 MHZ license and three 10 MHZ licenses in each of the 493 BTAs. Rand McNally partitions the 50 states and the District of Columbia into Major Trading Areas (MTAs) and Basic Trading Areas (BTAs). MTAs serve as regional units "of wholesaling, distribution, banking, and specialized services such as advertising" and can sprawl across several states. BTAs are smaller and represent communities of interest where consumers obtain "specialized services, such as medical care, entertainment,

Continued

Most recently, AT&T, MCI, Sprint, the CAPS, wireless carriers, and cable television service providers have all announced plans to step up their efforts to compete with SBC in offering similar packages of products and services. For example, in the June 12, 1996 issue of The Wall Street Journal, it was reported that Robert E. Allen, Chairman and Chief Executive Officer of AT&T, told some investment analysts that AT&T—the largest telecommunications company in the country, with a nationwide network, the most customers, and a brand name that is almost synonymous with telephony—"plans to take at least a third" of the $90 billion local telephone market within the next five years. Similarly, MCI and Sprint—the nation's second and third largest interchange carriers—have announced plans to enter the local exchange market nationwide by investing millions of dollars in local exchange facilities. CAPs (such as MFS and TCG) and cable television service providers (such as TCI and Time Warner) also have announced plans to compete in the provision of local exchange services. AT&T, MCI, MFS, TCG, and Time Warner have all received authority to provide local exchange services in competition with SBC in its geographic service territory.

*B. The Telecommunications Act of 1996*

The '96 Act became effective on February 8, 1996. This was the most extensive re-write of our nation's telecommunications laws in the past 60 years. The promise of the '96 Act was a removal of all legal and regulatory entry barriers, and a process whereby over time, all telecommunications service providers would have the freedom to provide whatever packages of services are demanded by their customers. According to the Conference Report accompanying the '96 Act, Congress intended "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."

One of the most significant objectives of the '96 Act was to open the local exchange telecommunications industry to competition. Congress established a new framework for the development of local exchange competition. First, it removed state and local barriers to entry by competitors of the incumbent local exchange carriers, which had the effect of eliminating the exclusive local exchange franchise granted by the states. Second, Congress imposed a set of general access and interconnection obligations on all local exchange carriers and some additional obligations on the incumbent local exchange carriers, all of which are designed to facilitate the entry of local exchange competitors pursuant to a strict timetable. Congress specifically left the particular terms and conditions of interconnection to "good faith" private party negotiations between the incumbents and competitors. Third, in recognition of the fact that regulation of local exchange telephony has historically been an intrastate matter under the control of state public service commissions, Congress gave the states a significant role in the development of local exchange competition. If and when the parties reached an impasse, Congress specifically provided that the state commissions would arbitrate those unresolved issues. Congress further required that access and interconnection agreements, whether they are arrived at through negotiation or arbitration, be approved by the state commissions. Finally, Congress specifically established the pricing standards state commissions would apply in arbitrations to ensure just and reasonable rates for interconnection, unbundled network elements, reciprocal compensation, and resold services. In this regard, Congress made it clear that incumbent local exchange carriers, which are required to make their networks and services available for use and resale by their competitors, would recover their actual costs of doing so which may include a reasonable profit.

The '96 Act also contains a mechanism whereby the regional Bell companies can receive authorization to provide in-region interLATA services. When a regional Bell company enters into one or more state approved access and interconnection agreements with one or more competing providers of telephone exchange service to residence and business customers either exclusively or predominantly over their own facilities, or when it generally offer access and interconnection pursuant to a state approved statement of general terms and conditions if no such provider has requested such access and interconnection, the regional Bell company may apply to the FCC for interLATA relief.

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higher education and a daily newspaper." As such, BTAs can include one or more counties. Rand McNally, 1992 Commercial Atlas & Marketing Guide 36–39 (123d ed. 1992).

*1. SBC's experience under the '96 Act*

Immediately upon enactment of the '96 Act, SBC began to fulfill its obligations to open the local exchange to competition.

As a first step, SBC assembled a core group of fifty full-time negotiators, account managers, and attorneys to receive requests for negotiations and to begin the negotiation process. This core group reports to a Vice President of SWBT, who has the full backing of SBC and access to the necessary resources to successfully compete negotiations and to consummate access and interconnection agreements with local exchange competitors. SWBT is also actively developing a statement of general terms and conditions under which it will offer access and interconnection.

As of the end of August, SBC had received 55 requests for negotiation, has signed 17 interconnection agreements, has entered into 5 arbitrations of some issues with some competitors in four of its states, and had 2 state commission approved agreements. SBC currently has signed interconnection agreements with American Communications Services, Inc. ("ACSI"), American Telco Inc., Brooks Fiber Communications, Dial US, Kingsgate, MFS, Texas Communications South, TCG, Time Warner, and US Telco. SBC currently is in arbitration with AT&T, MCI, MFS, TCG, and ACSI.

It is my understanding that other local exchange carriers are experiencing similar success in negotiating and consummating access and interconnection agreements under the '96 Act. This is evidence that private party negotiations and state supervised arbitration can work to introduce competition in the local exchange marketplace. Moreover, SBC and the other regional Bell companies have every incentive to enter into such agreements. As indicated above, consummation of state approved access and interconnection agreements with facilities-based local exchange competitors is one way in which the regional Bell companies can obtain interLATA relief.

*2. The FCC's Reports & Orders*

Just as the negotiation and arbitration process established by Congress is bearing fruit, the FCC intervened to change the rules of the game in a significant and counterproductive way. In doing so, the FCC has gone far beyond the limited role Congress prescribed for it. The two sections of the '96 Act which define the new paradigm for the development of local exchange competition contain only 9 pages of legislative language. Yet, on August 8, 1996, the FCC released two *Reports & Orders* which when combined contain over 800 pages of text, with over 4000 footnotes. With these *Reports & Orders*, the FCC has replaced Congress' "national policy framework" of private party negotiations and state supervised arbitration with a pervasive federal regulatory scheme of "national standards and rules" which define every significant term and condition of access and interconnection. The FCC's *Reports & Orders* leaves virtually nothing for negotiation or arbitration. The FCC has preempted the role preserved for the states by Congress, and has, in essence, "nationalized" control of the local exchange industry. Thus, the FCC has transformed what Congress intended to be the rapid development of local exchange competition into a federal bureaucratic morass of rules and regulations.

The FCC's rules are unsound not only on jurisdictional grounds, but also on economic and policy grounds. For example, the FCC has issued mandatory pricing rules for interconnection and access to unbundled network elements, which only allow the use of forward-looking incremental costs based upon the use of the most efficient technology. These pricing rules do not take into account the incumbent local exchange carriers' existing network design, nor the technology that is currently in operation. Furthermore, these pricing rules ignore prudently made network investments reflected in the incumbents' embedded costs. Contrary to the express language of the '96 Act, the FCC's pricing rules deprive the states of the ability to determine just and reasonable rates in accordance with the pricing standards in the '96 Act, and deprive the local exchange industry of receiving just compensation for the use of its property.

One of the most significant goals of Congress in passing the '96 Act was "to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services." The FCC's pricing rules will negatively affect the technological development of the local exchange networks. Under the FCC's rules neither the incumbent local exchange carriers nor their new competitors will have any incentive to make the necessary investments to deploy such advanced technology and services. In fact, just the contrary is likely to occur. The incumbents will have reduced incentive to make those investments, because they will not be fully compensated for doing so when their competitors make use of their facilities. New competitors will have little incentive to do so, because under the FCC's rules they can obtain everything they need to provide a package of end-to-end services at a below cost price with no capital at risk. In either event, the rate of new investments

in technology in the local exchange will be stifled, and innovation in local exchange services will be retarded.

Finally, the FCC's release of its *Reports & Orders* also immediately brought a great deal of uncertainty to the development of local exchange competition. The National Association of Regulatory and Utility Commissioners and several states have filed petitions for review of the FCC's preemption of state commission jurisdiction. Similarly, many local exchange carriers, like SBC, have also filed petitions for review. The appeals from the FCC's decisions will place the local exchange industry and the development of competition in a state of confusion. Until the appeals are decided, the parties will not know whether the current FCC's rules will ultimately apply. If the court of appeals determines that the FCC exceeded its jurisdiction, the case undoubtedly will be remanded back to the FCC with instructions. The FCC will then have to begin a new rulemaking, and the state commissions and the parties will have to start the negotiation and arbitration process all over again. Surely, this is not what Congress intended in passing the '96 Act.

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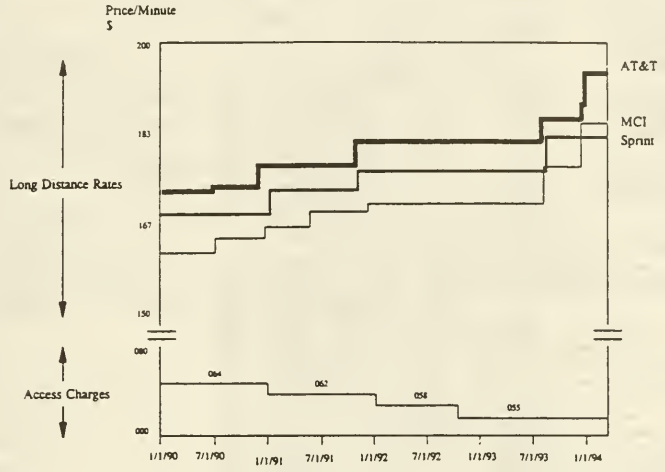
ATTACHMENT 1—BACKGROUND INFORMATION ABOUT SBC AND PACTEL

SBC is one of the world's leading diversified telecommunications companies. It is headquartered in San Antonio, Texas and has 59,000 employees. SBC serves 14.2 million access lines within its traditional five state region of Arkansas, Kansas, Missouri, Oklahoma and Texas, where it provides local exchange, exchange access and intraLATA toll telephone services, enhanced calling services, wireless services, messaging services, telecommunications equipment, and directory advertising and publishing under the "Southwestern Bell" brand name. Out-of-region in the U.S., SBC provides wireless services in broad market areas serving portions of Illinois, Massachusetts, Maryland, New York and Virginia, including the metropolitan areas of Chicago, Washington/Baltimore, Boston, Buffalo, Rochester, Syracuse and Albany under the "Cellular One" brand name. SBC also provides traditional cable television services in Montgomery County, Maryland and Arlington County, Virginia. Internationally, SBC has an equity ownership interest in local and long distance service companies in Mexico, Chile, and the United Kingdom; in wireless service companies in Mexico, France, Chile, South Africa, and South Korea; in cable television companies in the United Kingdom, Mexico, France, Chile and Israel; and in directory publishing in Israel and Australia. Over the past five years, SBC has lead the regional Bell companies in revenue growth and earnings. This year, SBC was identified by Fortune Magazine as "America's most admired telecommunications company."

PacTel is also one of the regional Bell companies. Its headquarters are located in San Francisco, and it has 49,000 employees. PacTel serves 15.8 million access lines in approximately 75% of California, including the major metropolitan areas of Los Angeles, San Diego, and San Francisco, and 33% of Nevada including Reno. It provides local exchange, exchange access and intraLATA toll telephone services, voice mail and other information services, Internet access services, network integration services, and directory advertising. PacTel also owns personal communications services ("PCS") licenses to provide wireless services throughout California and Nevada.

## Trends in Long Distance Rates and Exchange Access Charges




Source: WEFA Group, Economic Impact of Eliminating The Line-of Business Restrictions on the Bell Companies, July 1993; Robin Gareiss, Rate Hikes: MCI, Sprint Follow AT&T's Lead, Communications Week, August 9, 1993, at 60; Dan Reingold, Merrill Lynch Global Securities Research, LD Industry Benefits from AT&T Price Hike, Again, Jan. 25, 1994; Eric Paulak, AT&T, MCI Jack Up Rates Again, Network World, Jan. 24, 1994, at 37. With the exception of the two most recent rate increases, long distance rates are based on the average price per minute for basic service. For the two most recent rate increases, rates are estimated as the average of their stated range of rate increases, if a range was announced. AT&T rates are estimated as the average of its business rate increases and its residential rate increases -- a conservative estimate, considering that more revenue comes from business customers than from residential customers.

Attachment 2

## Competitive Access Providers In Southwestern Bell Telephone Company's Territory

| CAP Operation | City | State | Mrkt Area | Status | Year Started | Route Miles | Bldgs Srvd (b) | Switches Installed |
|---|---|---|---|---|---|---|---|---|
| American Communications Services, Inc. (ACSI) | Little Rock | AR | A | Operational | 1994 | 7 | 34 | |
| Brooks Fiber Properties | Little Rock | AR | A | Operational | 1994 | 19 | 24 | |
| Time Warner Communications (TWC) of Fayetteville | Little Rock | AR | A | Planned | 1996 | | | |
| ACSI | Austin | TX | C&WT | Planned | 1994 | | | |
| MCI Metro | Austin | TX | C&WT | Developing | 1995 | | | |
| Metro Access | Austin | TX | C&WT | Operational | 1995 | 40 (a) | 28 | |
| Metropolitan Fiber Systems (MFS) | Austin | TX | C&WT | Planned | 1994 | | | |
| TWC of Austin | Austin | TX | C&WT | Operational | 1994 | 120 (a) | 10 | Installed |
| ACSI | El Paso | TX | C&WT | Operational | 1994 | | | |
| Brooks Fiber Properties | El Paso | TX | C&WT | Planned | 1995 | 20 | | |
| GST Telecommunications | El Paso | TX | C&WT | Planned | 1995 | | | |
| Metro Access | El Paso | TX | C&WT | Planned | 1995 | 15 | 12 | |
| TWC of El Paso | El Paso | TX | C&WT | Developing | 1995 | | | |
| Teleport Communications Group (TCG) | Lubbock | TX | C&WT | Planned | 1994 | | | |
| MCI Metro | Dallas | TX | DFW | Operational | 1994 | | | Pending |
| Metro Access | Dallas | TX | DFW | Operational | 1995 | | | |
| MFS | Dallas | TX | DFW | Operational | 1990 | 141 | 209 | Installed |
| TCG | Dallas | TX | DFW | Operational | 1990 | 303 | 90 | Installed |
| TWC of Dallas | Dallas | TX | DFW | Planned | 1995 | | | |
| ACSI | Fort Worth | TX | DFW | Operational | 1994 | | 33 | |
| Metro Access | Fort Worth | TX | DFW | Operational | 1994 | 105 | 57 | |
| TCG | Fort Worth | TX | DFW | Operational | 1994 | | | |
| MCI Metro | Houston | TX | H | Developing | 1994 | | | |
| MFS | Houston | TX | H | Operational | 1989 | 259 | 165 | |
| Phonoscope | Houston | TX | H | Operational | 1989 | 400 | 35 | |
| TCG | Houston | TX | H | Operational | 1990 | 317 | 115 | Installed |
| TWC of Houston | Houston | TX | H | Operational | 1994 | 265 | | |
| MFS | Kansas City | MO & KS | KC | Planned | 1992 | | | |
| Kansas City Fibernet | Kansas City | MO & KS | KC | Operational | 1986 | 250 | 60 | |
| Springfield Fiber Net | Springfield | MO | KC | Planned | 1992 | | | |
| Kinnet | Various Cities | KS | KC | Operational | 1989 | 1200 | | |
| Hyperion Telecommunications | Wichita | KS | KC | Operational | 1993 | 130 (a) | | |
| Brooks Fiber Properties | Oklahoma City | OK | O | Operational | 1994 | 88 (a) | 50 | |
| Cox Fibernet (TCG Affiliate) | Oklahoma City | OK | O | Operational | 1991 | 120 | | |
| Dobson Fiber | Oklahoma City | OK | O | Operational | 1992 | | | |
| Indian Nations Fiberoptic | Oklahoma City | OK | O | Developing | 1994 | | | |
| MFS | Oklahoma City | OK | O | Planned | 1995 | | | |
| Brooks Fiber Properties | Tulsa | OK | O | Operational | 1986 | 105 | 42 | |
| MFS | Tulsa | OK | O | Planned | 1995 | | | |
| Digital Teleport | St. Louis | MO | SL | Developing | 1994 | | | |
| Intermedia Communications | St. Louis | MO | SL | Developing | 1993 | 481 (a) | 348 | |
| MCI Metro | St. Louis | MO | SL | Developing | 1994 | | | |
| MFS | St. Louis | MO | SL | Operational | 1992 | 80 | 42 | Installed |
| SP Telecom | St. Louis | MO | SL | Planned | 1994 | | | |
| TCG | St. Louis | MO | SL | Operational | 1993 | 91 | 41 | |
| CSW Communications | Corpus Christi, Harlingen, McAllen | TX | ST | Operational | 1994 | 200 | | |
| CSW Communications | Laredo | TX | ST | Planned | 1995 | | | |
| TWC (Fibrcom) | Laredo | TX | ST | Planned | 1994 | | | |
| ICG Access Services | San Antonio | TX | ST | Planned | 1995 | 306 | | |
| Metro Access | San Antonio | TX | ST | Developing | 1995 | 45 | 27 | |
| TWC (Fiorcom) | San Antonio | TX | ST | Operational | 1992 | 248 | 64 | |

NOTES: (a) under construction, (b) at least

STATUS: Operational is defined as actually providing service to customers. Developing is defined from deploying fiber to marketing service to customers. Planned is defined as expressing interest in establishing a network in that city.

01/25/96

Attachment 3

## Competitive Access Providers In Southwestern Bell Telephone Company's Territory

| CAP Operation | Sources: |
|---|---|
| American Communications Services , Inc. (ACSI) - Austin | Austin American Statesman 02/08/95 |
| ACSI - El Paso | Connecticut Research Report 10/01/95, Telco Competition Report 03/04/94 |
| ACSI - Fort Worth | Connecticut Research Report 10/01/95, Fort Worth Star Telegram 04/27/94 |
| ACSI - Little Rock | Connecticut Research Report 10/01/95,<br>Public Utility Commission Filings 08/12/95 |
| Brooks Fiber Properties - El Paso | City Franchise Filings 10/30/95 |
| Brooks Fiber Properties - Little Rock | Connecticut Research Report 10/01/95 |
| Brooks Fiber Properties - Oklahoma City | Connecticut Research Report 10/01/95, Telecommunications Reports 07/04/94 |
| Brooks Fiber Properties - Tulsa (Formerly PSO MetroLink) | Connecticut Research Report 10/01/95, Press Release Newswire 02/08/95<br>FCC Fiber Deployment Update 04/94 |
| Cox Fibernet (TCG Affiliate) - Oklahoma City | Connecticut Research Report 10/01/95, The Daily Oklahoman 08/31/94<br>Cox Cable Newsletter 3/91 |
| CSW Communications, Inc. - Corpus Christi, Harlingen, McAllen, Laredo | Connecticut Research Report 10/01/95 |
| Digital Teleport | St. Louis Post Dispatch 10/24/94, West Countrun 12/01/94 |
| Dobson Fiber | Weatherford Daily News 08/13/93 |
| GST Telecommunications (Texas Lightwave) - El Paso | Faulkner Information Services 01/95 |
| ICG Access Services - San Antonio | San Antonio Express News 10/19/95 |
| Indian Nations Fiberoptic - Oklahoma City | City Council Meeting Transcript of Lawton, OK 04/26/94 |
| Intermedia Communications - St. Louis (Formerly St. Louis FiberNet) | Press Release Newswire 01/30/95, Connecticut Research Report 10/01/95 |
| Kansas City FiberNet (TCI controlling interest) | Multichannel News 07/17/95, Connecticut Research Report 10/01/95<br>Kansas City Star 01/18/94 |
| KINNET | Wichita Business Journal 01/21/94 |
| MCI Metro - Austin | Austin American Statesman 02/08/95 |
| MCI Metro - Dallas | Connecticut Research Report 10/01/95, Reuters 01/04/94 |
| MCI Metro - Houston | Reuters 01/04/94 |
| MCI Metro - St. Louis | Reuters 01/04/94 |
| Metro Access - Austin | Connecticut Research Report 10/01/95<br>Austin American Statesman 03/23/94, 02/08/95 |
| Metro Access - Dallas | Connecticut Research Report 10/01/95 |
| Metro Access - El Paso | Connecticut Research Report 10/01/95, Dallas Business Journal 10/07/94 |
| Metro Access - Fort Worth | Connecticut Research Report 10/01/95, Fort Worth Star-Telegram 01/17/95 |
| Metro Access - San Antonio | Connecticut Research Report 10/01/95, Dallas Business Journal 12/02/94 |
| Metropolitan Fiber Systems (MFS) - Austin | Austin American Statesman 12/05/93 |
| MFS - Dallas | Connecticut Research Report 10/01/95, Telecommunications Reports 8/23/93 |
| MFS - Houston | Connecticut Research Report 10/01/95 |
| MFS - Oklahoma | Application for Certificate of Public Convenience and Necessity 11/18/94 |
| MFS - St. Louis | MFS PRNewswire 3/20/95, Connecticut Research Report 10/01/95 |
| Multimedia Hyperion Telecommunications- Wichita | The Wichita Eagle 10/16/94, 03/07/94 |
| Phonoscope - Houston | Houston Post 10/26/92, Faulkner 01/94, YankeeVision 12/94 |
| SP Telecom | Application for Certificate of Services Authority 12/23/95 |
| Teleport Communications Group (TCG) - Dallas | Connecticut Research Report 10/01/95, TCG Press Releases 11/09/94, 08/31/95 |
| TCG - Fort Worth | Dallas Morning News 03/07/94, Fort Worth Star-Telegram 03/02/94 |
| TCG - Houston | Connecticut Research Report 10/01/95, TCG Press Release 11/09/94,<br>Houston Business Journal 09/08/95 |
| TCG - Lubbock | TCG Presentation Slide 03/23/94 |
| TCG - St. Louis | Telco Competition Report 03/30/95, Connecticut Research Report 10/01/95 |
| Time Warner Communications (TWC) of Austin | Connecticut Research Report 10/01/95, Cable World 08/29/94 |
| TWC - Fayetteville | Connecticut Research Report - 10/01/95 |
| TWC (Fibrocom ) - Laredo | San Antonio Express News 01/28/95 |
| TWC - El Paso | El Paso Times 03/11/95, Faulkner 03/95 |
| TWC (Fibrocom) - San Antonio | San Antonio Express News 01/28/95, Connecticut Research Report 10/01/95 |
| TWC of Houston | Communications Daily 04/06/94, Houston Business Journal 01/12/96 |

01/25/96

The CHAIRMAN. Mr. Ebbers.

## STATEMENT OF BERNARD J. EBBERS

Mr. EBBERS. Good afternoon, Mr. Chairman and distinguished members of the committee. My name is Bernie Ebbers. I am the president and CEO of LDDS WorldCom, one of the four largest long distance telecommunications companies in the United States, headquartered in Jackson, MS. WorldCom offers domestic and international voice, data and video products, and services to business customers and other carriers, including the residential market. The company operates a nationwide digital fiber optic network and has worldwide network capacity. WorldCom was founded in 1983 as a long distance reseller and I have served as its president since 1985.

I can't resist asking the famous political question from the 1992 Presidential debates. Why am I here? I find it a little bit peculiar to be in the midst of companies who sent their pit bulldogs as attorneys to represent them instead of other CEO's, but my understanding is that the members of this committee have some interest in a merger we announced last month.

WorldCom and MFS Communications Co., Inc., have executed a definitive agreement and plan a merger. MFS is a leading provider of communications services for businesses and government. It has led the way in toppling legal barriers to competition in the local telephone markets and is constructing and operating new fiber optic networks in 45 cities nationwide and internationally, financed with our own money, not with ratepayers' money.

Our combination with MFS will indeed create a uniquely integrated telecommunications firm providing a single source for a full range of local, long distance, Internet, and international service over an advanced fiber optic network. The novelty of our deal stems from the fact that neither the local network portion of the consolidated entity nor the long distance portion is an incumbent monopoly or a former monopoly. Like WorldCom, MFS is a young entrepreneurial upstart with no captive customers plunging headlong into competition with much bigger and more established players in the industry.

What every company in this industry wants to accomplish is to be able to provide end-to-end service over a single company's own facilities. I believe the combined company will be a leader in assisting businesses to harness the full power of the Internet-based technologies. I am particularly excited about our combined ability to meet the explosive demand for corporate intranets utilizing technologies and facilities available from a single source. The combined company can also advance U.S. competitiveness overseas by combing MFS's and WorldCom's international positions, particularly in Europe.

Thank you very much.

The CHAIRMAN. Well, thank you.

[The prepared statement of Mr. Ebbers follows:]

PREPARED STATEMENT OF BERNARD J. EBBERS

Good morning Mr. Chairman and distinguished members of the Committee. My name is Bernard J. Ebbers. I am the President and CEO of LDDS WorldCom, one

of the four largest long distance telecommunications companies in the United States. Headquartered in Jackson, Mississippi, WorldCom offers domestic and international voice, data, and video products and services to business customers, other carriers and the residential market. The company operates a nationwide digital fiber optic network and has worldwide network capacity. WorldCom was founded in 1983 as LDDS Communications, a long distance reseller, and I have served as its President since 1985.

That is the same year the Bell Companies began their massive 10 year lobbying campaign to get Congress to reverse the brand new antitrust consent decree that separated them from AT&T, kept them out of the long distance business, and ordered them to provide equal access in order to promote competition and lower prices for long distance services. It's fairly obvious that the 1984 antitrust decree is a competition success story. Both business customers and American consumers everywhere have enjoyed long distance calling and faxing at pennies per minute, affordable international calling, economical inbound 800 services, easy Internet access and more. People typically choose from more than half a dozen carriers vying for their long distance business. Cash incentives are not uncommon even for households within modest usage.

By the mid 1990's, Congress was ready to answer the Bells' call for legislation. A consensus developed that Americans deserve the same benefits of innovation and competition in local telephone service as they have enjoyed in long distance service. So after countless false starts, Congress last February passed the very pro-competitive Telecommunications Act of 1996. As you know, the new law is both a long overdue update of the antiquated 1934 Act, which based all telecommunications on a regulated monopoly utility model, and a rational plan for dismantling the 1984 consent decree. The '96 Act directs the FCC and the states to eliminate monopoly conditions in local telecom services and promote competition.

The Bell Companies will be permitted to sell long distance services within their regions once certain competitive conditions have been met in local markets on a state by state basis. The Bells will then be free to offer their customers one-stop shopping and full service packages.

Last year, some in Congress actually expressed hope that the Bell Companies would compete against one another in the local telephone business. After all, they do so in the cellular service business and in publication of directories. But so far, for technical reasons of spectrum allocation, the cellular business is a cozy duopoly in each market. And directories are not reliant on monopoly local networks. Real competition in regular local telephone service is much more elusive. No Bell Company is competing for the captive local customers of any other Bell. Ironically, despite their recognized expertise in the provision of local telephone service, not one of the Bells' applications to offer service in an out of region state requests certification as a local carrier. And by planning their mega-mergers, four of the Bell Companies have made their non-compete policies official.

Soon after the Act was passed, a close-cousin of the Bells, GTE, broke onto the scene in the long distance industry. Using both its local exchange networks scattered around the country and long distance network capacity purchased at competitive rates from WorldCom, GTE signed up a quarter of a million long distance customers in its first few months of long distance operations. GTE is offering one-stop shopping for local and long distance to its business and residential customers. And GTE is not alone. Southern New England Telephone (SNET) has been doing likewise in Connecticut. The problem is, almost no one in America yet has a choice for local telephone service or a choice of full service vendors.

I can't resist asking that famous political question from the 1992 Vice Presidential debates, "Why am I here?" My understanding is that members of this Committee have some interest in a merger we announced last month. WorldCom and MFS Communications Company, Inc. (MFS) have executed a definitive agreement and plan of merger. MFS is a leading provider of communications services for business and government. It has led the way in toppling legal barriers to competition in local telephone markets, and is constructing and operating new fiber optic networks in 45 cities nationwide and internationally. Our combination with MFS will indeed create a uniquely integrated telecommunications firm providing a single source for a full range of local, long distance, Internet and international service over an advanced fiber optic network. The novelty of our deal stems from the fact that neither the local network portion of the consolidated entity nor the long distance portion is an incumbent monopoly or a former monopoly. Like WorldCom, MFS is a young, entrepreneurial upstart with no captive customers, plunging headlong into competition with much bigger, more established players in the industry.

In fact, as the new Telecom Act and the FCC have recognized, all new entrants in local telecom markets, including ourselves, will continue to rely substantially on

the incumbent local exchange carriers for interconnection with their single ubiquitous switched network. That is why the FCC agonized for months and its staff worked round the clock earlier this summer to craft the interconnection rules that will make competition possible. The billions of dollars of investment already spent and planned to be spent by MFS and many others in local fiber rings, local switches and more cannot begin to fully duplicate existing Bell networks that reach into every home and office in their regions. In other words, we and other new entrants will continue to rely on Bell interconnection even where we have our own facilities, and that dependence will be far greater in markets where we still lack our own facilities.

So I am truly flattered at the attention bestowed on us by the Judiciary Committee. With a whopping 5% market share in long distance, I expect our teaming up with a company having even less than 1% market share in local service amounts to a big yawn in terms of antitrust issues. I guess it is the boost in the potential for real local competition that has attracted most of the media attention. And incidentally, World Com's success should certainly dispel those tired old Bell claims of some cozy oligopoly or cartel controlling the long distance business.

To fill in some of the details: the combined company will be known as MFS WorldCom. We hope to complete the merger within four to eight months. Since WorldCom's networks will connect to MFS' city networks, we expect to achieve significant cost savings from reduced line and access costs. The merger will also eliminate duplication of capital spending programs, including those for undersea capacity, international facilities and MFS' planned U.S. intercity network. MFS recently merged with UUNET, a leading provider of a comprehensive range of Internet access options, applications, security products and consulting services. The combined MFS WorldCom will be uniquely positioned to deliver competitive services that will help meet the ambitious goals of the new Telecom Act.

What every company in this industry wants to accomplish is to be able to provide end to end service * * * over a single company's own facilities. I believe the combined company will be a leader in assisting businesses to harness the full power of Internet-based technologies. I am particularly excited about our combined ability to meet the explosive demand for corporate "Intranets" utilizing technology and facilities available from a single source. The combined company can also advance U.S. competitiveness overseas by combining MFS' and WorldCom's international positions, particularly in Europe.

I was asked to describe some of the effects our combination with MFS will have on competition and whether there will be anticompetitive effects. I have already suggested some of the positive effects on competition, but you may be more interested in what outside observers have said. First, in terms of local telephone service, the Wall Street Journal on August 27th reported that "In the past four years, MFS has done for local service competition what MCI originally did to break AT&T monopoly in long distance * * * various proposals, such as allowing local customers to switch carriers and keep their original phone numbers were pioneered by MFS." The Jackson Clarion Ledger reported on the same day that the merger "positions WorldCom to take on the Baby Bells." In other words, it positions us to avoid being crushed by them. According to USA Today, "the merger would help MFS and WorldCom fight the big boys."

Secondly, in terms of effects on competition in long distance, the Clarion Ledger quoted industry analysts as saying "the merger produces a true fourth competitor to the biggest long distance providers AT&T, MCI and Sprint." According to the Wall Street Journal, "combining with MFS effectively pushes WorldCom into new markets where it needs to operate if it is going to keep up with the other long distance giants." USA Today reported that "the deal could make the combined company, MFS WorldCom, a major player in telecom, just a rung below the regional Bells, GTE, MCI, AT&T and Sprint." USA Today also predicted MFS WorldCom "could be a next generation MCI" and that we "may help push down local and long distance rates."

In terms of anticompetitive concerns, I respectfully suggest they are non-existent in the case of MFS WorldCom. USA Today quoted analysts saying that "the companies are merging because they have to." "Big telecom finds are getting bigger and moving toward one-stop shopping. Witness Bell Atlantic and NYNEX announcing they will merge as will SBC and Pacific Telesis. It's a defensive move for both [WorldCom and MFS]."

Unfortunately the Bells still have a monopoly on anticompetitive effects in telecommunications. Their state and local political clout is matched only by their complete market dominance and both are simply unparalleled in modern industry. Combinations of these monopolies violate the pro-competitive spirit of the new Telecom Act. They extinguish some of the best potential for local competition. My personal

view, although I am no antitrust expert, is that competition needs a chance to develop before the monopolies just get bigger.

Hopefully our new bundled services will become uniquely attractive to our customers. But unlike the Bell Companies, we will never be able to sell a bundled package on the basis of the fact that the customer has no other choice of vendor for any one piece of that package.

The CHAIRMAN. We will allow for 7 minutes of questioning per person here. Let me just ask a few questions and all three of you can answer, if you would care to. If you don't care to, just say so.

As I understand it, the Telecommunications Act was designed to promote competition among providers and increase consumer choice primarily by breaking down regulatory barriers and permitting everyone in the telecommunications industry to get into competition with one another with everyone else's business.

I guess this question is directed to Mr. Young and Mr. Ellis. How would your merger be consistent with these goals? Mr. Young.

Mr. YOUNG. First of all, as I indicated in my written testimony and my oral remarks, we think this combination is going to better position us to compete with the likes of MCI-British Telecom, with AT&T, and with Sprint and its other European backers. This is a market where size matters, where size and scope are critical to develop customer brand identification, in developing the kinds of efficiencies that Mr. Ellis was talking about; scale and scope in procurement; scale and scope in research and development, which is a critical factor going forward. The greater size of the company is going to better enable us to be a full-service provider competing head to head with the likes of AT&T, MCI, and Sprint.

The CHAIRMAN. Mr. Ellis.

Mr. ELLIS. Well, Senator, I would say that I think that the promise of the legislation was to introduce competition with or without our kind of merger. In the Southwestern Bell territories of 5 States, we have, as I speak, 115—latest count, I believe—applications for competitors to come in and provide local exchange telephone service. That speaks for itself. Pacific Telesis has something approaching another 100 competitors who are coming in under the Telecommunications Act to go into the market and compete for local exchange telephone service.

Our merger, I think, will make us a stronger competitor, both in terms of the local exchange business, but also, more importantly, it will make us a better competitor in the long distance business. We will start with zero market share in long distance and we will go into it and be vigorous competitors, and we will be more vigorous and better competitors with the combined company than we would have been otherwise.

The CHAIRMAN. Well, some of our panelists today may very well suggest that you ought to satisfy certain conditions, such as interconnection performance standards or compliance with section 271 of the Telecommunications Act, before your merger is approved by regulators. Interconnection performance standards, as I understand it, are already provided for in the Telecommunications Act and section 271 governs the Bells' entrance into the long distance market.

Frankly, I do not believe it is proper to include either of those conditions as part of the antitrust legal analysis that should be applied by regulators to your mergers. What is your view? I take it you agree with me on that.

Mr. YOUNG. I am hard-pressed to disagree, Mr. Chairman. [Laughter.]

The CHAIRMAN. Hard-pressed to disagree. I like witnesses who agree with me. In fact, I even like witnesses who don't, but that is one thing that I am concerned about.

Mr. Ebbers, what is your feeling about that?

Mr. EBBERS. Well, Mr. Chairman, if we had any reason to feel comfortable with the fact that they would comply with the checklist if the merger went through, it wouldn't be an issue. But we certainly don't feel confident that that will occur and I, for one, believe that should be a precondition.

The CHAIRMAN. Mr. Ebbers, I congratulate you on what certainly appears to be a very impressive record of growth with your company and, as you put it, "plunging headlong into competition with much bigger, more established players in the industry." I believe that such entrepreneurial success stories are vital to the American economy.

What are your goals for local exchange market share in the next 5 years?

Mr. EBBERS. Market share?

The CHAIRMAN. Yes.

Mr. EBBERS. Mr. Chairman, it is so small that it is hard to put a percentage on it. We are currently building out local networks, our own local networks, in 45 markets and intend to expand that to 85 markets over the next 3 years. And if we are as successful as we think we will be, we would still be substantially less than 10 percent of the market.

The CHAIRMAN. Doesn't your merger with MFS and your projected growth for the merged company in the local exchange market prove that there already is competition in the local exchange market and that it is likely to be much more competitive in the coming years? Doesn't it kind of show that?

Mr. EBBERS. Mr. Chairman, certainly this merger, the ability to combine with the local exchange company, is the result of a very good telecommunications bill and an absolutely tremendous ruling by the FCC on the interconnection order. Those people are to be complimented greatly on what they have done. That was the driving force behind this.

But the fact of the matter is that even though we have agreements with six of the regional Bell operating companies—the one missing is U.S. West and that is almost impossible to get so we have kind of laid that aside—none of those agreements meet the checklist and they are substantially different from the checklist. But because we are investing in our own local facilities, we are going ahead and trying to compete on whatever basis we can.

The CHAIRMAN. OK. Now, how much of an advantage do you think an incumbent local exchange provider would have in the long distance market due to customer loyalty and/or preference for so-called one-stop shopping?

Mr. EBBERS. Well, they have a tremendous advantage, and the whole goal of our company is to position ourselves so that we can have access to an originating customer. One of my fellow panelists mentioned a little while ago that they do not have any long distance revenue. Well, that is just not true. They have a substantial

amount of intraLATA revenue and, in addition to that, have massive plans out to extend local calling areas so that they can redefine a long distance call from long distance to local.

The CHAIRMAN. But don't you think it works both ways; that is, wouldn't an incumbent long distance provider have an advantage in the local market due to customer loyalty or for preference for one-stop shopping?

Mr. EBBERS. Well, we don't know how loyal the customer is because they have never had a choice.

The CHAIRMAN. So you are not sure what the answer is to that?

Mr. EBBERS. No. We are very confident that the customers will choose the best provider of services, and we intend to be one of those.

The CHAIRMAN. Well, let me just go back to Mr. Young and Mr. Ellis. Just one last question. It has been suggested that the regional Bells have a unique capacity to compete with each other due to their experience in delivering local exchange service. Do you folks agree, and who do you see as your primary competitors in the near future, and who do you see as your primary competitors in the residential markets?

Mr. YOUNG. Mr. Chairman, I think when you look at who are the primary competitors in the local exchange, the list is pretty logical. It is people who already have facilities in place to compete. It is people who already have customer contacts in business in place. That is the long distance carriers, that is the cable companies, and it may well in the future be wireless providers.

In particular, in addition to those elements, companies like AT&T have just enormous presence with the customer. If you stopped 10 people randomly in almost any city in the country and asked them who their local exchange carrier is, they would tell you AT&T. So they are the people who are really best positioned to compete in our market.

As for Bell Company competing with Bell Company, maybe the best example I can give to you, there is just a couple months ago the FCC had a proceeding on competition in New York in connection with a regulatory issue we don't have to go into in great detail here. The FCC went through all the people that they thought were going to compete in New York. We weren't on the list.

The CHAIRMAN. Mr. Ellis.

Mr. ELLIS. Well, I would agree with what Mr. Young said. AT&T I accept at their word; that is, their intention is to obtain in the next 5 years approximately one-third of the local exchange business. But I want to come back to what I said before. We have people voting with their entry into the business today. We have 115 companies who have filed applications to get in the local exchange business in our 5 States today and there are approximately 100 in California and they include all the big ones, the household names. So, I think there will be an abundance of local exchange competition.

The CHAIRMAN. Mr. Ebbers, do you have any comment about that?

Mr. EBBERS. Well, the only significant part is that it doesn't take a lot of effort to file an application. The ability to do it on a profitable basis is an altogether different matter.

The CHAIRMAN. We will go to Senator Leahy first, since he was here earlier.

Senator Leahy.

Senator LEAHY. I will yield to Senator Feingold.

The CHAIRMAN. Senator Leahy will yield to Senator Feingold.

## STATEMENT OF HON. RUSSELL D. FEINGOLD, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator FEINGOLD. Thank you, Mr. Chairman, and thank you, Senator Leahy. I thank our witnesses for being here today. I and other members of this committee requested this hearing after the second of two mergers of regional Bell operating companies [RBOC's] was announced this spring.

The 1996 Telecommunications Act promised to open up to competition markets which were previously closed either by technology or regulatory barriers. Cable companies were to compete with the local exchange monopolies, and vice versa. Long distance companies would be able to enter markets for local service, and the RBOC's were going to compete not only in long distance, but with each other, for local service. All of this promised competition was to provide lower prices, better service, and more choices to consumers.

The mergers discussed by this first panel, however, raise serious questions about whether the 1996 act will actually make good on its promise. Media reports indicate that both long distance rates and cable rates have increased since the bill was enacted, and many companies have proposed to increase local telephone rates as a part of the implementation of the act. And now the most likely competitors to the RBOC's in local service according to some telecommunications analysts, and other RBOC's, are merging with one another. The rash of merger activity in broadcast and cable also suggests that concentration, not competition, has been the result of the Telecommunications Act, at least in the short run.

The benefits to consumers that would have resulted from competition between these merging entities may be lost if they are approved. The question is, Will any of the efficiencies gained from the merger be passed on to consumers, and if so, will those savings exceed those possible under a more competitive market?

Mr. Chairman, I ask unanimous consent that the rest of my statement be placed in the record.

The CHAIRMAN. Without objection, we will put it in the record.

[The prepared statement of Senator Feingold follows:]

### PREPARED STATEMENT OF SENATOR RUSSELL D. FEINGOLD

I want to thank Chairman Hatch for his willingness to hold this hearing today, in response to a request Senator Leahy, Senator Kohl and I made earlier this year to examine the very critical issue of competition in telecommunications markets. We asked for the hearing following the announcement of the proposed mergers between Bell Atlantic and NYNEX and between SBC and PacTel.

These mergers raise the question as to whether the goal of the 1996 Telecommunications Act to encourage and promote competition within both established and emerging telecommunications markets is being achieved under the Act.

Congress designed that Act to allow providers of different types of services to enter into other areas of business. It was expected that cable providers to compete with monopoly local exchange companies in providing local service. It was expected that the regional bells operating companies would begin competing with one another to provide local and long distance service, and to provide extensive video program-

ming and cable service. Congress also eased the rules under which the RBOCs could enter the lucrative long distance market in order to increase competition in that already-competitive market.

The proposed mergers we are focusing on today however, raise the question of whether or not consumers will actually see greater competition in telecommunications and its associated benefits of lower prices, more choices and better services. It is unfortunate that some of the companies represented her today will be partners instead of competitors.

I recognize that mergers are not inherently anti-competitive and in some situations can provide tangible benefits for consumers. But I think this Committee has to examine some of these mergers by asking "How much competition in these markets is precluded by the merger compared to the real or perceived benefits to consumers under the merger?" Will consumer prices fall as a consequence of the merger? Would they have fallen more in the absence of the merger? Is it possible that rates will rise as a result of the mergers?

Those are important questions in the context of the 1996 Telecommunications Act. When we considered that bill earlier this year, I was extremely concerned that the legislation permitted far too much concentration in a number of telecommunications markets and that shareholders, not consumers, would reap the benefits of this legislation. In light of both of the proposed mergers and the progress of the rulemaking, I am still concerned that the promise of the bill has been overstated.

An August 11, 1996 Washington Post article suggested the benefits of the Act may have been overstated by its proponents. It states:

> Six months after enactment of the landmark Telecommunications Act of 1996—the law that is supposed to foster competition in cable and phone rates—the only thing that has changed for consumers is that their cable and long-distance bills are higher not lower.

I was equally concerned earlier this year by the proposals submitted to the FCC to increase local phone rates by $2.50 to $11.00 per month, as part of the move towards competition. I wonder how popular this legislation would have been earlier this year if consumers were told to expect local rate increases as opposed to the rate decreases promised them.

Merger activity hasn't been limited to the telephone industry. Since the enactment of the Telecommunications Act there have been a rash of proposed mergers between companies that were also likely competitors with one another.

I am concerned about the implications of the proposed mergers:

between U.S. West and Continental Cable—two companies that could compete to provide both cable and television;

between Time Warner and Turner Broadcasting—a merger which increases concentration in the cable industry; and

between Westinghouse/CBS and Infinity, creating a broadcasting powerhouse.

FCC Chairman Reed Hundt said in June, the Commission's Mass Media Bureau had already processed 2,100 assignment and transfer applications for radio and television, a 42% increase over the previous year. That is in response to lifting of broadcast ownership restrictions. Again, more concentration—not more competition.

This extensive merger activity raises the questions of who controls and disseminates information in this country, and how many different voices we want relaying that information.

This Committee has a responsibility to carefully examine the implications of these mergers, not just from the pure anti-trust angle of whether the mergers should be approved. It is clear that we must urge the Department of Justice and other regulatory bodies to carefully review these mergers and to impose conditions where necessary. However, we must monitor whether the legislation enacted earlier this year is achieving its fundamental goal of increasing competition in telecommunications, rather exacerbating concentration.

Senator FEINGOLD. Let me use part of my remaining time to ask Mr. Young and Mr. Ellis a question. You both apparently indicated prior to my arriving that you didn't consider your partners as potential competitors. I guess I am wondering about that because so many RBOC's indicated an interest in competing in each other's market for many types of communications services just a few months ago when we were debating the telecommunications bill.

Could you tell me why the markets of your partners aren't attractive to you for any line of telecommunications service, as I un-

derstand a lot of long distance originates in those regions? And as a followup, are you considering entering the markets of any other RBOC's? Let's start with Mr. Young.

Mr. YOUNG. Yes, thank you, Senator. One thing I think I do have to take issue with is the assertion that the Bell companies were the most logical competitors of the other Bell companies. I would like to direct you, if I could, to my written testimony. One of the things I tried to do in preparing for this testimony to sort of test that was to go back into 1995 and look at what the Justice Department said, look at what the administration said, look at what the FCC said when they talked about who were the most likely people to get into the local exchange business.

Now, the people they listed were the long distance carriers. They listed wireless companies, they listed cable companies. But as I point out in my written testimony, you can go through statement after statement, filing after filing, and the Government did not point to Bell companies as logical competitors to go into other Bell territory, and the reason for that, I think, is pretty logical.

The reason is that in considering where you want to expand operations, you want to do that where you already have facilities in place, where you already have customer contacts, where you already have name recognition. For example, in New York, AT&T has that. The cable companies have that. The long distance carriers have that. A lot of the wireless companies have that. I don't have that. I don't have any significant advantage, so that is why that is not a logical place for me to enter.

Senator FEINGOLD. Did you have any problem with my representing, though, that the RBOC's had indicated an interest in competing in each other's areas? Is that an accurate statement of what was, in part, part of the discussion?

Mr. YOUNG. Senator, as I grow older, my memory grows foggier, and the record is what the record is, but that is certainly not my recollection.

Senator FEINGOLD. Mr. Ellis.

Mr. ELLIS. Yes, Senator. I have a little bit different situation in my answer. As I said, our files confirm that we had no plans to go into California, and California had no plans—that is, Pacific Telesis—to come into SBC's territory. SBC has a presence in Chicago, Boston, Washington, Baltimore, and a major part of New York. We are active competitors with NYNEX, Bell Atlantic, and Ameritech.

I think that by most measures, we are probably among, anyway, their largest competitors, SBC is, no question about it, and we will grow that b siness in those areas. We have filed to be a local exchange competitor in New York and in Illinois. We will be a full, one-stop provider—local exchange, long distance, and cellular—in those places. Our plan, however—and the reason we are not potential competitors with Pacific Telesis is based on this. We believe it is important to have three components present before you move in. One, you need facilities. Two, you need branch identification. Three, you need customers.

Now, not in every case—you can go ahead and try and go in, but when you have the opportunities we have to pursue the situations I have ticked off, plus others, we had chosen a long time ago not to go into California for those reasons. Our files—the Justice De-

partment has had them; they have looked at them; longstanding. That has been our plan. We were not a potential competitor for Pacific Telesis, but indeed we are a potential competitor in those situations that I have outlined.

Senator FEINGOLD. Thank you. Let me go back to Mr. Young for a minute on the specific example of Bell Atlantic and NYNEX. It was a matter of public record some time prior to the announcement that there were discussions going on, and, I guess, what I would like to ask you is, Did Bell Atlantic first examine the competitive opportunities available to them in the NYNEX region, particularly in the States where your service areas abut one another? Was that examined or did you just go forward with——

Mr. YOUNG. The answer to the question is, yes; we did examine that. Actually, you might be misled when you look at a map. You might think that our service territories abut all the way along the New York border, all the way along Pennsylvania. Actually, that is not true. A lot of that is independent telephone company territory. Really, it is just New York and across the river to New Jersey.

We looked at that, but we concluded pretty much along the lines that Mr. Ellis described that it wasn't worth the candle for us to go in because we did not have facilities in New York. We didn't have a customer presence, and we didn't think we had anything significant by way of brand identification.

Now, even there you might say to yourself, OK, but, look, we have telecommunications facilities in northern New Jersey. Wouldn't we think we had some advantage? We could just extend the wires under the river and use that plant that we had in New Jersey to serve in New York. What we found out was that that was not the economical thing to do. There is already so much traffic in New Jersey and the area that you can serve with those facilities in New Jersey. Because of the traffic loads, you really can't extend into New York. So, yes; we did have a careful look at it, but we decided long before the merger discussions that this was not a market we wanted to enter.

Senator FEINGOLD. Do I have more time, Mr. Chairman? Just one more question, if I may.

Senator THURMOND [presiding]. Yes.

Senator FEINGOLD. Thank you very much, Mr. Chairman. Just to follow on sort of what you were talking about there, you wouldn't have done this merger if it didn't involve sufficient cost efficiencies to be gained, and I saw in your press materials at the time of the merger announcement that the Bell Atlantic-NYNEX merger will result in cash savings of $900 million a year. Your press materials reported that would result in substantial shareholder value, but as far as I saw it didn't mention the benefits to consumers.

How specifically will those cost savings be passed down to consumers, and what do you anticipate the average savings might be to ratepayers and how soon might those savings be realized?

Mr. YOUNG. Well, if I could take that question in pieces, first of all, even before the merger we think we have been doing a good job in passing along our efficiencies to our customers. We have in Bell Atlantic, in almost all our States, and NYNEX has in almost all their States—one exception is Vermont, where it is being nego-

tiated—price cap plans that basically freeze residential rates and guarantee that over the life of the plan, those rates will go down compared to inflation. Now, that is really sharing cost savings with customers.

One other area, though, where I think customers are really going to see the benefit here, is in new services. You know, it is an expensive proposition to build out our networks so that we can provide new services and, for example, compete with the cable companies. The greater size of the new company will be able to get equipment at better prices. This is particularly important when you are talking about cutting-edge equipment, new technology. You want to get your volumes up so you can get the unit costs down because that is the way this industry works.

By putting the companies together, we are going to be able to get better prices to upgrade our network so that we can compete with the cable companies, and that also is going to provide a very real consumer benefit.

Senator FEINGOLD. I thank the chairman and simply want to say if there is any way I could get this quantified, and the timeframe, subsequent to this hearing—I have run out of time—I would appreciate it so I could get a little better sense of how the consumers will benefit. I thank the witnesses. Thank you, Mr. Chairman.

Senator THURMOND. Mr. Young, Mr. Ellis, and Mr. Ebbers, in that order, will each of you please give us your views on concerns raised about whether local competition will ever broadly develop for business and residential customers, despite the best efforts of the Congress? While many large companies are currently interested in entry, is it clear, in your opinion, that robust local competition will ultimately be achieved?

Mr. Young.

Mr. YOUNG. Yes; Mr. Chairman, I do believe there will be substantial local competition. A lot, of course, along the way will depend on what regulators do. If I could point to something Mr. Ellis said a few minutes ago, I think there are a number of provisions of the FCC's section 251 interconnection order that—because they are going to require companies like mine to provide network elements at below cost, I think those will actually interfere with the development of competition. But if I can for the moment assume away what I consider errors by regulators, yes; I think we will see significant local exchange competition.

Senator THURMOND. Mr. Ellis.

Mr. ELLIS. Yes; I agree with that. I believe that what the Congress put in place will work if the FCC construes it in a correct way. I think that, unquestionably, the intent of Congress was to open both the local exchange that had previously been a regulated monopoly to full competition—they set in place the vehicles to do it—and at the same time they put a pathway for the regional Bell companies to get into long distance. They put great incentives on our part to cooperate, to make it happen, and I believe that ultimately it will work if the FCC implements the act as it was written by Congress.

Senator THURMOND. Mr. Ebbers.

Mr. EBBERS. I think that all depends, Mr. Chairman, on whether the Bell operating companies will get out of the courts and decide

to start complying with the interconnection order issued by the FCC and get on with the business of the day rather than the legal issues of the day.

Senator THURMOND. As I indicated in my opening statement, I am interested in hearing views about how competition in local and long distance services may develop over the next few years, and particularly your estimates of the number of likely competitors with substantial shares of those markets. Would each of you care to comment?

Mr. YOUNG. Well, I will start, Mr. Chairman. It is going to vary substantially geography by geography. If you take the New York market today, you have about 20 significant competitors who are either certified or in the process of becoming certified and actually building facilities. In northern New Jersey, you have about the same number. We have significant numbers, and I would be happy to provide them for the record, if you would like, Mr. Chairman, in Philadelphia, in Pittsburgh, in Washington, DC, and Baltimore.

As a matter of fact, today as we speak we are providing to Mr. Ebbers unbundled elements, as the act requires, in many respects; unbundled loops, for example, in Baltimore. How many there will be in any particular market—my crystal ball gets foggy a little way out, but I think it is pretty clear there will be a substantial number of people competing.

Mr. ELLIS. I agree with that, Senator, but I would like to comment on something Mr. Ebbers has suggested or implied twice, and that is that the regional Bell companies would not implement, or we are dragging our feet or would not provide compliance with the law. I would say on behalf of SBC that I have been general counsel for this company for 8 years and in that time, to my recollection, we have never had a finding by a regulatory body or a court that we have in any way refused to interconnect, degraded service, or in any way conducted ourselves that would justify a question about our fitness to hold licenses.

We go before the FCC, we go before the States. We are subject to massive regulation of every type and, to my knowledge, there has never been a single situation, at least in the last 8 years, in which there has been a question of whether we would be in compliance with an FCC order or a congressional order. It is not in our interest to do so. We have provided interconnection arrangements for over 20 years to long distance competitors. We have provided them to cellular competitors, we have provided them to CAP's. We have a record that I am proud of.

We receive laudatory comments on the quality of our interconnections, and I think it has no place to suggest that we would do anything other than comply with the law. We disagree with the FCC's order, but as we sit here we are vigorously complying with that order, and will. As much as we think it is wrong and as much as we are going to take and pursue our remedies in the courts, we are going to comply with it as long as it is the law of the land.

Mr. YOUNG. Mr. Chairman, if I could add just briefly, because I know time is short, I would like to underline the last——

Mr. EBBERS. Mr. Chairman, it is my turn to speak, isn't it, sir?

Mr. YOUNG. I just wanted to say we agree. The FCC order is currently the law of the land. We have to comply with it. We are challenging it, but we are complying with it. My apologies.

Senator THURMOND. Mr. Ebbers.

Mr. EBBERS. Mr. Chairman, the issue is one of economics, how many competitors there will be in the local market, and at a 17- to 25-percent discount for reselling bundled services, there will be very little competition in the local market because the cost of selling those services—the overhead costs of selling those services do not provide enough margin to effectively get into that market, unless you want to do it as a loss leader, and most of the time it is going to be very difficult to sustain a loss leader philosophy.

If the FCC order is put into effect and we put in our own switches, that then allows us up to a 40-percent margin. It is also a fact that that margin will yield, because of the increased cost of providing the services—some of the orders that we have to fill out are manual orders that are 16 pages long to get local service, and if we have to do that, then our overhead costs will increase substantially and there will be minimal competition on that basis. The reason for our merger with MFS is that we feel the only vehicle for us to compete profitably in the local service market is to build our own facilities.

Senator THURMOND. Mr. Young or Mr. Ellis, if the modification of final judgment did not prohibit consolidation of Bell companies in the past, why did your companies not seek to merge sooner in order to capture the hundreds of millions of dollars of efficiencies that you believe will result from your pending mergers?

Mr. ELLIS. Well, Senator, our answer is very straightforward. We were concerned that we wanted to see what the legislation was going to be. As you may recall, for, I guess, the last two sessions, there were any number of different bills that came out and it was important to us to have some idea what the future would hold, what it would look like.

Mr. YOUNG. Mr. Chairman, I think Mr. Ellis is right. The legislation accelerates the head-to-head competition with giants like AT&T, British Telecom-MCI, Sprint and its European partners, and it really accelerates the need for us to take a market response.

Senator THURMOND. I believe my time is up.

Senator Leahy.

Senator LEAHY. Thank you, Mr. Chairman. I have had, as we all have, to go back and forth to votes, but I understand in earlier testimony, Mr. Young, you had responded to some of the things that I had said, and we will go into that in just a moment.

Mr. YOUNG. Yes.

Senator LEAHY. And, Mr. Ellis, correct me if I am wrong on this. You testified that SBC and PacTel never had any intention to compete with each other. Is that correct?

Mr. ELLIS. That is correct, sir.

Senator LEAHY. And I have heard the same thing about Bell Atlantic and NYNEX.

Mr. YOUNG. That is correct.

Senator LEAHY. In fact, in testimony that Bell Atlantic filed before the Vermont Public Service Board last Friday, it said that not only did the company have no plans to compete in Vermont as a

local exchange carrier, but it had no intention to compete anywhere in the NYNEX region. Bell Atlantic, as I understand it, said New York City was perceived as already too competitive.

Well, let's assume that New York City is too competitive, whether it is or not. Then why did Bell Atlantic decide not to look at places such as Vermont, where most agree that such intense competition does not exist?

Mr. YOUNG. Mr. Senator, in looking at new markets to enter—I am at a risk of maybe repeating a little bit of what I had in my testimony.

Senator LEAHY. I understand. You just have to bear with me. I am new and young at this, but I will do my best to keep up with you, Mr. Young.

Mr. YOUNG. I appreciate that. When we look at a market for entry, we do what any business would naturally do. We look to see do we have some advantage; is there a reason for us to think that this is a place where we could do pretty well. When you are a telecommunications company, the factors that you look at are things like do you have significant brand recognition there; do customers know who you are; are you going to have to spend a lot of money just for people to get to know who you are.

Senator LEAHY. Did you feel that in Vermont people wouldn't know who Bell Atlantic was?

Mr. YOUNG. Compared to AT&T and MCI and Sprint, no. We think our brand recognition is substantially lower. You also look at things like do I have——

Senator LEAHY. We even get newspapers up there, you know. We are out in the back woods, but we do know——

Mr. YOUNG. Senator, I grew up in the country, too, so I appreciate that. But you also look at other factors like do you have facilities there; do you already have customer contacts and business relationships with significant customers. And when you look at a market like Vermont, we don't, and so that is why—when we look at a decision like that, that is the reasoning behind it.

Senator LEAHY. But intense competition was not one of the reasons, then?

Mr. YOUNG. Well, I will take your word for what the filing said and all I can say is——

Senator LEAHY. No; I am not saying what the filing said. Would intense competition not be a reason?

Mr. YOUNG. Well, certainly, if I thought there was a good market and I could be the first one in, sure, I am going to be more anxious to get into that market than if I think there is a market with three people or four people or seven people are already in there providing service. I think that is only logical.

Senator LEAHY. Wouldn't everybody?

Mr. YOUNG. I think so.

Senator LEAHY. If you could have the monopoly, you would rather be there.

Mr. YOUNG. I am not talking about monopoly. I am talking about maybe being the first one in to compete with the monopolist.

Senator LEAHY. Well, we are going to have more monopolies to compete with as we go along, it appears to me, but let me ask this. The Telecommunications Act was expected to create this environ-

ment in which companies would compete in each other's markets. Now, I am told that a number of long distance companies and local access providers have filed for interconnection to the local phone networks of incumbent Bell companies in order to bring some kind of competition in the local loop. The Bell companies, of course, can do the same thing, but they haven't.

Now, Mr. Ebbers, as I read your written testimony, you point out the irony that despite their expertise in providing local phone service, quote, "not one of the Bells' applications to offer service in an out-of-region State requests certification as a local carrier." Am I being fair?

Mr. EBBERS. That is fair, sure.

Senator LEAHY. Is it correct that no Bell company has filed for interconnections with a local carrier outside of their own service territory?

Mr. ELLIS. That is not correct, Senator.

Senator LEAHY. It is not?

Mr. ELLIS. Southwestern Bell, SBC Communications, has filed in Illinois and New York.

Mr. EBBERS. They really filed for long distance and you don't have to file a separate filing for local, so it kind of goes automatically in those two States.

Mr. ELLIS. That is not correct, Senator. We have filed to obtain a certificate to provide local exchange telephone service in Illinois and New York.

Senator LEAHY. Both of you gentlemen will—at some point, the staff will be provided with your testimony, but if you want to add to that or add anything to me on it, feel free.

When was this, Mr. Ellis?

Mr. ELLIS. It was shortly before—and the record will be what it is, but I believe it was before the legislation was passed.

Senator LEAHY. And that is the only one?

Mr. ELLIS. Those are the two, Senator. I am not sure if you were here, but I said our plan, our practice, has been to file where we have network facilities, to compete where we have network facilities, where we have a brand name—Cellular One in Chicago, Cellular One right here in Washington, DC—where we have customers. That is the strategic plan that has been SBC's for a long time. Several years ago, the Department of Justice interviewed, deposed, our people in connection with the motion to vacate. That was the testimony then and we have acted on that plan.

Senator LEAHY. Will we see more Bell companies trying to expand local service under the Telecommunications Act, if you had to predict, Mr. Young?

Mr. YOUNG. Well, let me say this. One, I think that you comé back to the criteria that both Mr. Ellis and I have been talking about. If a local exchange carrier or any other carrier has a logical platform in any particular local service area that allows them to enter—if they have facilities, if they already have customers there, if they have significant brand recognition—if they have several of those elements, yes, I think you will see that. If they don't have those elements, then I think it is a tough thing to do.

Senator LEAHY. Would you agree with that, Mr. Ellis?

Mr. ELLIS. Well, I would say, Senator, that we have got a lot to deal with. As I mentioned, we have 115 requests for competitors to come in and provide local exchange in our 5 telephone States, and approximately 100 in California, and they are the biggies as well as the small ones. So I think we will look, in accordance with our strategic plan, at each situation. Will we come to Washington? I don't know, and I don't know the timetables.

Senator LEAHY. So you say it will be a case-by-case situation?

Mr. ELLIS. Within the criteria I said. One other thing, Senator, I would like to point out. The problem that Mr. Ebbers and others have talked about in terms of competing for local exchange is, in part, a product of the fact that historically local telephone rates have been kept very low. In Texas, for example, the State regulators have decided that the Texas telephone rate for 24-hour-a-day service is less than $10. Now, we didn't choose that. That was imposed; that was the Texas regulatory policy decision. I wish they could be closer to cost, but that is what it is. So I can understand anybody coming in and saying, whether you have 20-percent discount off of $10 or what you have, that that is a problem. But it is not a problem that is a result of something SBC Communications did.

Senator LEAHY. If I was at all parochial, I would say you have got to have some advantage to live in Texas, but I am not going to say that. [Laughter.]

Mr. Ebbers, did you want to add anything to this?

Mr. EBBERS. No; Senator, I don't want——

Senator LEAHY. I take your point, Mr. Ellis. I don't mean to be flippant on that.

Mr. EBBERS. I think Mr. Young and Mr. Ellis have clearly articulated the reason why we won't have effective local competition, RBOC in RBOC region. They come to it from a monopolistic attitude. You have to have a customer base already. They are not willing to go out and compete for one. You have to have facilities already. They are not willing to go out and build them. They have to have name recognition already. They are not willing to go out and build name recognition. For our purposes, we are perfectly happy to start from the ground and work our way up.

Senator LEAHY. Let me ask something in the long distance area, and to bring it back home. The Vermont Public Service Department issued a draft telecommunications plan for the State a few weeks ago and it said, quote, "Opportunities for combined long distance revenues appear to be the driving force behind," and it goes on to say "the NYNEX-Bell Atlantic merger." This somewhat puzzles me because the Telecommunications Act permits a Bell company to get into the long distance market in its own region only when it meets the interconnection and unbundling checklist, but the companies are free to go into the long distance market outside their own region.

Now, when you merge the companies and you dramatically increase the size of your region, it strikes me that you are, in fact delaying your own ability to offer some kind of long distance in your own regions? In other words, if Bell Atlantic didn't merge with NYNEX, it could begin offering long distance service in the NYNEX

area, or vice versa. But when they combine, then you have got to go through all these other hoops.

Will the mergers, in fact, delay your entering the long distance market in the new combined regions?

Mr. YOUNG. Well, Senator, I think maybe another way of characterizing what you have just said is that because the merger increases our in-region footprint, what it does is increase our incentive to meet the checklist, to comply with the unbundling requirements of the statute, because now the long distance carrot that we get by meeting all those requirements got bigger.

Senator LEAHY. So you are saying the mergers won't delay your entering the long distance market in the new combined regions?

Mr. YOUNG. Well, I think what they do is provide an even greater incentive for us to meet the checklist, and we are very hopeful that we are going to be able to meet the checklist, market by market, promptly so that we can start providing some real price competition for the ordinary consumer that AT&T, MCI, and Sprint are not doing today.

Senator LEAHY. Is it your professional judgment that you are more apt to be into that market with a merger than you would have been otherwise?

Mr. YOUNG. Senator, my judgment is that I think we will probably into the long distance market area by area on about the same schedule as we would have without the merger.

Senator LEAHY. Do either of you gentlemen want to add to that?

Mr. ELLIS. No, sir.

Senator LEAHY. Mr. Ebbers.

Mr. EBBERS. No, sir.

Senator LEAHY. Mr. Chairman, if I might just ask one last question on this, do the mergers help Bell Atlantic and NYNEX, PacTel, SBC, better compete in the long distance market? I mean, Mr. Young, you seem to think they would.

Mr. YOUNG. Yes. Let me take that. Yes, I think they will help us compete in the long distance market. One of the reasons I say that is that an enormous cost of doing business in this industry is the cost of the equipment. Now, one of the things that you find out very quickly in this business is that if you want to get equipment at good prices, volume is everything. The bigger the volume, the better the price you get. That is true of cutting-edge, high-technology equipment, like the equipment that we are going to be installing in our networks so that we can provide video, for example. But it is true of other equipment as well.

So I think, for that reason alone, the equipment savings, yes, this does help us in the long distance market, but it helps us in a number of other areas as well—development of systems, development of other technology that we will need to be in the business. The economies of scale and scope do make a difference, yes.

Mr. ELLIS. I would just add to that to say that one of the reasons that we found the merger attractive with Pacific Telesis is they have a very strong, excellent cost performance shop. We believe we have an equally strong revenue-generating, marketing, product development shop. We put those two together and we think we have a very strong company that can go into—and I am sorry; before, I said we weren't in the long distance business. We are not in the

long distance business that we can't be in, the interLATA long distance business.

So we are going to start from zero, and we think that combination will make for a strong competitor, along with the other matters of scale that Mr. Young has talked about. I would again stress we are starting at zero, going into that long distance market.

Senator LEAHY. Well, Mr. Chairman, I know you want to move on and we are going to have other votes, and I will submit, if I might, my other questions for the record. I do have a number of other questions, but I will submit them for the record.

Senator THURMOND. Thank you.

[The questions of Senator Leahy are located in the appendix.]

Senator THURMOND. Before we move to the next panel, Senator Feingold, I believe you had a question.

Senator FEINGOLD. Mr. Chairman, I appreciate it very much, and I regret that I can't be here for the second panel, so I hope Mr. Atkinson, who is going to testify on the panel, doesn't mind if I just read a brief comment that he makes in his testimony and I would like Mr. Young's and Mr. Ellis' reaction.

He attaches an illustrative list of minimum standards to be attached to any merger approval that TCG believes to be reasonable and appropriate. He says, "How could a company of good intention object to this proposal? If the big Bell or any BOC, for that matter, intends to live up to the requirements of the Telecommunications Act, it should have no difficulty in committing to strict performance standards."

So with regard to this comment, TCG suggests that it should be easy to agree to minimum performance standards if the BOCs aren't anticipating service problems during the transition period. How do you gentlemen respond to that?

Mr. YOUNG. Senator, since I don't have the specific suggestion in front of me, it is a little hard to comment, but I don't want to hide behind that.

Senator FEINGOLD. Well, let me be fair to you. It has to do with keeping the local exchange competition whole relative to the level of performance and service that existed before the merger.

Mr. YOUNG. Well, on that issue, we have a number of interconnection agreements that we have been able to enter into, and the issue of service performance and accountability and liability in the event that our service performance doesn't meet particular levels—at least so far, with at least some providers, we have been able to negotiate mutually acceptable agreements. So at least in the past, this hasn't been a problem.

Now, I will tell you based on my exposure to this that, you know, some parties have been demanding service levels and liability levels that we think are just completely out of market. But when people have come in with reasonable requests, it has been very easy for us to split the difference and reach an agreement.

Senator FEINGOLD. So this could well, in the proper context, be a reasonable proposal?

Mr. YOUNG. It can, and I think it is most effectively dealt with in the structure that Congress has set up, negotiations between the parties with the oversight of the State regulators.

Senator FEINGOLD. Mr. Ellis.

Mr. ELLIS. Well, I would just add to that. We have 17 interconnection agreements, and they are negotiated one by one and they are private negotiations under the auspices of the States. In some of those agreements, the parties have negotiated both standards of performance and even liquidated damages.

But on this point, I will go back to what I said before. We, for many years, have looked at the whole area of interconnection, particularly with the number of customers—and that is what I will call them, carriers—that we have. We have performance standards, we have capabilities. They can come in and online monitor the quality of the access. This is an area we get rated by the FCC. They rate us, all the carriers.

At predivestiture, pre-1984, there could have been arguments, but this has not been, I submit, in the relatively—well, I will use 8 years—this has not been an area of controversy.

Senator FEINGOLD. Is this the kind of thing you would agree to, then, as a condition for merger?

Mr. ELLIS. It is absolutely not the kind of thing we would agree to as a condition for merger. We believe, unquestionably, this merger should be held to the same standard that the AT&T–McCaw merger was, that the MCI–BT, that the Sprint—I could go down the whole list, Disney, and so on—the law ought to be the same for everyone. What I am saying is under the act that was passed by Congress, that is a matter for private negotiations and it has worked. We have had 17 agreements with big and small, including people like Time Warner and MFS. So I am saying the process was working. The problem has come up because of FCC has gone off and tried to reregulate the system with a 700-page, single-spaced order. That is the problem.

Senator FEINGOLD. Mr. Chairman, we will pursue this again another time and I thank you very much for the extra time.

Senator THURMOND. Thank you, gentlemen, for your appearance.

We will now have the second panel come around—Mr. Michael Salsbury, Mr. William Barr, and Mr. Robert Atkinson. We will give each of you 5 minutes to make an opening statement, and please confine it to 5 minutes. You can put your entire statement in the record.

Mr. Salsbury, you may start.

**PANEL CONSISTING OF MICHAEL H. SALSBURY, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, MCI COMMUNICATIONS CORP., WASHINGTON, DC; WILLIAM P. BARR, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, GTE CORP., STAMFORD, CT; AND ROBERT C. ATKINSON, SENIOR VICE PRESIDENT, LEGAL, REGULATORY AND EXTERNAL AFFAIRS, TELEPORT COMMUNICATIONS GROUP, INC., STATEN ISLAND, NY**

**STATEMENT OF MICHAEL H. SALSBURY**

Mr. SALSBURY. Thank you, Mr. Chairman and members of the committee. My name is Michael Salsbury and I am executive vice president and general counsel of MCI Communications Corp. It is a privilege to testify before this committee today, and permit me at the outset, Mr. Chairman, to acknowledge the exemplary leader-

ship of members of this committee to ensure that the act recognized the critically important role of the Department of Justice in protecting and promoting competition in telecommunications markets.

Development of competition in the long distance industry since the breakup of the Bell System in 1984 pursuant to the MFJ is an extraordinary American success story. The changes spurred on by DOJ and the FCC gave American consumers and businesses multiple choices for long distance telephone service. Both large and small entrepreneurial companies now compete vigorously in the long distance industry.

The long distance cartel referred to by Mr. Young at this point has more than 500 members, has so far escaped detection by Federal and State competition authorities, and to date has been visible only to local exchange monopolists and their paid experts. Since 1984, long distance prices have declined almost 70 percent. Innovative long distance services, such as virtual networks, fax, and the Internet, have been introduced. Call quality has increased and customer service has improved dramatically.

Unfortunately, the MFJ did not address competition in local telephone service markets. These markets remain monopolies dominated by the seven RBOC's and GTE, which provide more than 99 percent of all the local telephone services in their service territories. Compared to the 42 million times customers changed their long distance carriers last year, no more than a handful of customers could obtain local service from more than one carrier.

Against this background, the intent of the act was, first, to pry open local telephone markets to competition and to reform and advance universal service arrangements so as to eliminate the current massive subsidy flows; and, second, once local markets were opened and effectively competitive, to promote further diversity and choice in long distance by permitting the RBOC's to enter the long distance market within their regions.

For the act's goals, two things are critically important. First, Federal and State regulators must implement the act in a manner consistent with Congress' procompetition intent. The FCC is off to the right start with its interconnection order issued last month. Yet, much of the implementation effort lies ahead. Because not one of the RBOC's or GTE has entered into a single interconnection agreement that meets the requirements of the act and the FCC's rule, the act now requires each State separately to outline those agreements in lengthy arbitration proceedings. This process will, no doubt, be further complicated by the appeals from the interconnection order filed by each of the RBOC's and GTE.

The second critical factor is DOJ's continuing role in ensuring that the evolution to competition in local markets does not jeopardize long distance competition either by premature entry of the RBOC's into the long distance market while they still remain monopoly power or by combination of RBOC monopolies that can delay and possibly frustrate development of local competition entirely.

We have met with representatives of the Antitrust Division and can report that they are preparing to carry out their statutory responsibilities in reviewing the RBOC applications for long distance

entry. The proposed mergers of Bell Atlantic and NYNEX and of SBC and Pacific Telesis, however, are very troubling and should be opposed. If permitted to proceed, these mergers would impede the development of local competition in each of these RBOC's regions and would create a substantial likelihood that the resulting mega-RBOC's would leverage their local monopolies to gain market power in the long distance market.

Although local telephone service remains a highly concentrated market, in no instance have RBOC's ever competed with each other in the provision of regular telephone service. In fairness, in the past State laws have often prevented that, but the act eliminated all such legal constraints. With the prospect of increased revenues and profits from the out-of-region business of their customers alone, one would expect to see demands for interconnection from other RBOC's and the beginnings of RBOC competition. After all, who better to compete in local service markets than the experienced, well-financed companies that have been doing it for 100 years?

Why, for example, wouldn't Bell Atlantic, which provides residential service to many New York executives, not try to win the telephone service of their businesses away from NYNEX? If Bell Atlantic wasn't interested in New York and SBC wasn't interested in the business in California, why are they buying these companies? This is, in fact, the justification Bell Atlantic gave some years ago when it tried to merge with TCI. At that time, Bell Atlantic's economists said that the only possible purpose and consequence of the merger would be to mount a direct competitive challenge across the board to the incumbent telephone companies, predominantly other BOC's. They are not saying that now. Why not?

I just might quickly conclude. The reason is that if they go into the other territories and demand interconnection, the other—if Bell Atlantic went into NYNEX' territory or if Southwestern Bell went into Pacific's, then the other companies would retaliate. They would demand interconnection from the other company and they would immediately start competing against each other, bringing local competition that much quicker. The answer to the monopolists' dilemma, Mr. Chairman, was to merge, not compete.

Thank you.

[The prepared statement of Mr. Salsbury follows:]

PREPARED STATEMENT OF MICHAEL H. SALSBURY

EXECUTIVE SUMMARY

It is a privilege to testify before the Committee on the state of competition in the telecommunications industry following enactment of the Telecommunications Act of 1996. I'd like to acknowledge the exemplary leadership of members of this Committee to ensure that the new law recognized the critically important role of the Department of Justice (DOJ) in protecting the promoting competition in the telecommunications marketplace.

MCI is uniquely situated to speak about competition in the industry because more than 25 years ago we successfully challenged the Bell System monopoly and brought competition to the long distance industry. We have experienced first-hand the anti-competitive shenanigans that an incumbent monopoly can engage in to frustrate new entrants that are trying to interconnect with its network and compete for customers. We know why it so necessary not only to have fair rules of the game but why you need the referees on the field for enforcement.

The Act holds the potential to spur the same kind of consumer benefits in the monopoly local market that long distance competition brought. Today, consumers have

many choices in long distance providers and rates have fallen nearly 70 percent over the last decade—the same long distance call that cost $1.77 (in 1994 dollars) ten years ago, would cost less than 58 cents today. The same is not true in the local telephone market dominated by the seven Regional Bell Operating Companies (RBOC's) and GTE. Their monopoly power and their ability to act anticompetitively is why the new rules of the game and the enforcement mechanisms are critical to realizing the goal of full competition in every telecommunications market. My testimony focuses principally on two areas of concern—the implementation of the Act and how the proposed RBOC mergers will harm competition.

Seven months after the passage of the Act, little in the local marketplace has changed. Consumers only have one choice for their local service provider. The incumbent monopolies, while crying that they are facing competition, are doing everything possible to thwart new entrants and kill its development. Within a month of the Federal Communications Commission's (FCC) issuance of new local competition rules, the incumbent monopolies have begun an enormous legal battle seeking to block the implementation of the Act. The monopolists' tactics of stall, disrupt and delay are exactly why we must have fair rules and good enforcement of the rules and playing conditions. In the near term, regulation must play its role as a substitute for competitive processes until true local competition—and market forces—fully develop.

The FCC is off to a good start in issuing its August 1 local competition rules, but these rules are only one part of a three part trilogy of necessary reforms. The trilogy must include:

*National Local Competition Rules*—Adoption of national rules to foster local competition throughout the U.S.

*Universal Service Reform*—A competitively-neutral universal service plan that increases the number of Americans on the network, provides access to basic and advanced services, eliminates hidden subsidies, ensures that all players contribute in an equitable manner and ensures that local service remains affordable in all areas of the country.

*Access Charge Reform*—Reform of access charges which currently result in long distance companies paying nearly half of every dollar to incumbent local monopolies. These charges are seven times the cost of providing access. Competition will not develop unless these charges reflect the true price of providing access to the incumbent's network.

As noted, the Act recognizes DOJ's preeminent role in safeguarding national pro-competition policies. In this regard, DOJ must critically examine the proposed mergers of Bell Alantic/NYNEX and SBC/PacTel. MIC views these proposed mergers as inconsistent with the pro-competition intent of the Act and in violation of our national antitrust principles. These mergers should be opposed. If these RBOC mergers were allowed, our nation would lose two powerful and resourceful competitors, both of which would likely be new entrants into the local markets now being served on a monopoly basis by their merger partners. Bell Atlantic-NYNEX would control 25 percent of the nation's access lines to customers and SBC-PacTel would control 21 percent. In other words, two huge monopolies would have bottleneck control of more than 45 percent of the nation's phone lines. These combined "mega-RBOC's" would also have a much greater ability to engage in anticompetitive activity if allowed to provide interLATA long distance service in their huge new intraregion markets because of the large proportion of calls on which they control both ends of access (i.e., calls that both originate and terminate within the new larger regions).

Assuming that the efforts of incumbent monopolists to thwart it fail, the development of local competition promised by the Act, one properly implemented, can produce the same kinds of consumer benefits that competition in the long distance market produced following the break-up of the Bell System—and more.

Mr. Chairman, actions taken by the FCC and DOJ in the coming months will in large part determine whether or not the Act's competitive goals—and the benefits to consumers that competition brings—are realized. To date, we have seen the RBOC's going to court, refusing to sign interconnection deals that meet the Act's competitive checklist, and doing all in their power not only to retain, but in the case of these proposed mergers, to expand their monopolies. I commend you for your diligence in publicly examining issues and I appreciate this opportunity to appear before the committee.

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Good morning, Mr. Chairman and members of the Committee. My name is Michael H. Salsbury. I am Executive Vice President and General Counsel of MCI Communications Corporation. It is a privilege to testify before this Committee on the

state of competition in the telecommunications industry following enactment of the Telecommunications Act of 1996 (Act).

Permit me at the outset, Mr. Chairman, to acknowledge the exemplary leadership of members of this Committee to ensure that the new law recognizes the critically important role of the Department of Justice (DOJ) in protecting and promoting competition in the telecommunications marketplace.

No one can question MCI's long-standing commitment to achieving full and fair competition in all telecommunications markets. MCI was the pioneer of competition in the telecommunications industry—first in long distance and now in local telephone markets. MCI has grown from a tiny upstart challenging the Bell System to an industry leader. In the process, MCI has become a diversified communications company offering consumers and businesses a range of services including long distance, wireless, local access, paging, Internet access, and more. MCI will continue to provide the innovative services our customers demand, including local telephone service, but can do so only if the Act is properly implemented and if regulators prevent anticompetitive behavior on the part of incumbent monopolies. In order to become a facilities-based competitor to the incumbent telephone monopolies, MCI created a subsidiary, MCImetro. If the right rules are in place and arbitrations with the Regional Bell Operating Companies (RBOCs) are successful, by early next year, MCImetro will have grown to operating local switches in 24 markets in 20 states.

## INTRODUCTION

For decades, the telecommunications industry was dominated by the former Bell System monopoly. Twelve years after the break-up of the Bell System, long distance is a highly competitive market with hundreds of competitors and prices that have decreased nearly 70 percent. The local telephone markets, however remain monopolies dominated by the seven RBOCs and GTE. The Act holds enormous potential for bringing competition to these monopoly markets, and while MCI is optimistic that this historic legislation will achieve that goal, it is far from a foregone conclusion. Several critical events must occur before that will even be possible. My testimony will focus principally on two areas that require special attention: implementation of the Act (a "trilogy" of key regulatory decisions) and the proposed RBOC mergers.

First, the Act must be properly implemented by both federal and state regulators in a way that is consistent with Congress' pro-competition intent. While the Federal Communications Commission (FCC) if off to the right start with the August 1 release of its local competition rules, much of the Act's implementation lies ahead. Not a single state has arbitrated an interconnection agreement pursuant to Section 252 of the Act. Moreover, FCC decisions in two key proceedings—universal service and access charge reform—are still months away. These two items, together with successful implementation of local competition rules, form what the FCC has labeled a "trilogy" of key decisions needed to launch local competition and preserve long distance competition. If successfully executed, this trilogy promises to bring lower prices and innovative telecommunications services to all Americans.

Second, certain pending industry mergers will harm competition and impede achievement of the Act's goals. The Act opens to competition a $500 billion communications and information market with exploding growth potential. Many players in this market, including MCI, have and will form alliances to offer innovative new products and services and increased geographical reach. We do not assert that such economic activity should be discouraged. To the contrary, joint ventures and mergers may strengthen competition in the market. Not all mergers, have such beneficial results.

MCI views the proposed mergers of Bell Atlantic with NYNEX and SBC Communications (SBC) with Pacific Telesis (PacTel) as inconsistent with the pro-competition intent of the Act and in violation of our national antitrust principles. These mergers should be opposed. If these RBOC mergers were allowed, our nation would lose two powerful and resourceful competitors, both of which would likely be new entrants into the local markets now being served on a monopoly basis by their merger partners. Bell Atlantic-NYNEX would control 25 percent of the nation's access lines to customers and SBC-PACTel would control 21 percent. In other words, two huge monopolies would have bottleneck control of more than 45 percent of the nation's phone lines. These combined "mega-RBOCs" would also have a much greater ability to engage in anticompetitive activity if allowed to provide interLATA long distance service in their huge new intraregion market because of the large proportion of calls on which they control both ends of access (i.e., calls that both originate and terminate within the new larger regions).

Assuming that the efforts of incumbent monopolists to thwart it fail, the development of local competition promised by the Act, once properly implemented, can

produce the same kinds of consumer benefits that competition in the long distance market produced following the break-up of the Bell System—and more.

LONG DISTANCE COMPETITION BENEFITS THE ECONOMY & CONSUMERS

Mr. Chairman, the development of competition in the long distance industry since the break-up of the Bell System is an extraordinary American success story. The changes spurred on by the DOJ and the FCC gave American consumers and businesses multiple options for long distance telephone service. Both large and small entrepreneurial companies now compete vigorously in the long distance industry.[1]

The development of a highly competitive long distance industry has been a boon for the U.S. consumer. A 1995 study[2] by Dr. Robert Hall of Stanford University confirmed what the world already knew—that long distance competition created hundreds of new businesses as new carriers entered the market, stimulated an unprecedented surge in technological innovation, and caused call quality to soar as long distance companies criss-crossed the nation with fiber optic networks that today comprise the Information Superhighway. In addition, and perhaps most importantly, competition drove real long distance prices to American consumers down by almost 70 percent between 1985 and 1995. The same long distance call that cost $1.77 (in 1994 dollars) ten years ago, costs less than 58 cents today.

Notwithstanding the facts, the RBOCs argue that the long distance industry is not competitive.[3] This view appears to be motivated more by a desire to influence public policy than by a reasoned and impartial evaluation of the facts; it is notoriously wrong. Since 1995, while the RBOCs were spreading their propaganda to policy makers, many on Wall Street realized that the firms in the long distance industry were vigorously fighting for market share through price competition, quality improvements, and new and innovative service offerings.

FCC figures also demonstrate vigorous long distance industry competition. AT&T market share measured by revenue slipped almost one percentage point in the first quarter of 1996 to 55.1 percent, continuing the downward trend from 90 percent at divestiture in 1984; 67 percent in 1989; and 61 percent in 1993. Measured by traffic revenue, AT&T's share is now approaching 50 percent.

Change in market share, however, does not tell the whole story. Market share reflects only net customer turnover; if AT&T loses a customer to one long distance competitor but wins one from another, its market share remains the same. The actual turnover is a more accurate barometer of competition and it demonstrates extreme rivarly—long distance customers changed carriers over 42 million times in 1995, with a faster pace of turnover exhibited in the first quarter of 1996. In addition, smaller carriers continue to gain an increased share of the market. The FCC reports that "third tier" carriers have increased their share of the market revenue fivefold, from less than three percent in 1984 to more than 14 percent in 1995. The ability of new entrants to rapidly build market share is reflective of an open and competitive, rather than a non-competitive, market.

In addition to presenting misleading facts on market share in the long distance industry, the MacAvoy study's core conclusions are based on an analysis of long distance prices and costs that is totally flawed. According to the study, long distance prices are well above costs and the margin has been increasing over time. The two fundamental problems with the analysis are its pricing and cost data. There are several problems with the pricing analysis. First, it overstates consumer rates by ignoring important residential discount plans—such as the MCI "Sure-Savings," the AT&T "True Savings," and other discount plans. Second, it makes incorrect calling pattern assumptions.

It assumes that 85 percent of residential calls are made during the day, which is flatly incorrect and causes a gross overstatement of average residential prices. Third, it overstates business rated by ignoring business contract tariffs. Incredibly, the cost data leaves most of the costs incurred by long distance companies out of the equation—that analysis excludes billing, promotion, advertising, and most net-

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[1] In Utah and South Carolina, 27 long distance companies provide customized service to consumers and small businesses. In Texas, more than 100 companies offer a variety of long distance services. More than 70 companies compete in Pennsylvania and Illinois. In California, Michigan, Ohio, New York, Wisconsin, and Florida, more than 50 long distance companies are today offering service.

[2] Long Distance: Public Benefits from Increased Competition, 1995.

[3] The RBOCs are promoting the findings of a book by a paid economic consultant (Paul W. MacAvoy, *The Failure of Antitrust and Regulation to Establish Competition in Markets for Long-Distance Telephone Services* (Cambridge, MA: The MIT & AEI Press, 1996)) which concludes that the long distance companies have "stabilized" their market shares and have gotten so good at "signaling" what their prices will be that competition is not effective at lowering prices. Unless and until, of course, the RBOCs gain entry into the long distance market.

work costs. With the data errors corrected, the conclusions reached are the opposite: long distance prices have fallen dramatically over the last decade and that decline has outstripped the decline in access charges by a wide margin.

LOCAL TELEPHONE MARKETS ARE STILL DOMINATED BY MONOPOLIES

In marked contrast to the vigorously competitive long distance industry, there was no meaningful competition in local telephone markets when the Act was signed into law in February. Until preempted by Section 253 of the Act, local competition could not exist because most state prohibited competition by law or regulation. The House Commerce Committee Report noted that "the seven BOCs control over 80 percent of the local telephone network," "the top 10 telephone companies control over 92 percent of the local telephone network," and "in the large number of markets for local telephone service there was no instance where any of the top 10 telephone companies compete with one another."[4] Although a key objective of the Act is to bring full and open competition to the local market, little has changed in the last seven months. The $95 billion local telephone market is still dominated by monopolies.

In any given geographic area, only one company provides the conectivity that allows users to communicate with one another through the telephone. Anyone who wants telephone service–local or long distance–has to rely on the local telephone company to provide that conectivity. The RBOCs continue to monopolize both aspects of local telephone service in their serving areas: local exchange (calling friends and family across town) and exchange access (connecting you to your long distance phone company for long distance calls).

The RBOCs claim that they have been facing significant competition for exchange access traffic. Long distance companies pay about 40 percent of every revenue dollar for access. Approximately 99.4 percent of those dollars go to the local telephone monopolies. Industry-wide, long distance companies' payments to local monopolies last year exceeded $20 billion. MCI's access payments alone exceeded $5 billion. Compared to the billions of dollars paid to the RBOCs, MCI paid only $25 million—less than four tenths of one percent—to competitive access providers, or competitive local exchange carriers (CLECs). Competition in this market is far from a reality. Moreover, the RBOCs continue to experience growth in their access traffic volumes. In the last three years local telephone company access traffic has grown by more than seven percent a year. Even in two states where the presence of CLECs would be most likely to erode local telephone company access business—Illinois and New York—interstate access traffic growth for Ameritech and NYNEX has been about the same as the rest of the country.

The tiny pockets of emerging competition, which the RBOCs prefer to show through a magnifying glass to overstate their importance, do not today provide consumers with choices for local telephone service. Ironically, at the same time the incumbent monopolies are crying "competition," they are doing everything possible to squelch its development.

*Monopoly behavior stifles competition*

The RBOCs and GTE are doing everything possible to stifle competition in court, in the regulatory process, and in the marketplace. Barely a month has passed since the FCC issued its new local competition rules and the incumbent monopolies have already initiated a legal battle against the implementation of the Act. GTE and Southern New England Telephone (SNET) have sought to stay the effective date of the FCC's local competition rules, arguing that they will be damaged if the rules take effect. Last week, US WEST, Bell Atlantic, NYNEX, PacTel, and BellSouth petitioned the U.S. Court of Appeals for the District of Columbia to overturn the FCC's order, as did GTE. SBC filed a similar petition in the Court of Appeals for the Fifth Circuit in New Orleans. Although MCI believes that the stay applications will fail, this is yet another example of the incumbent monopolies' attempt to impede the competition process.

While the Act creates affirmative obligations on the part of the RBOCs to open their markets to competition, the interconnection agreements that have been signed between the RBOCs and their potential competitors are few and interim in nature and with companies interested primarily only in terminating traffic over the RBOCS' networks. Not one of the agreement addresses of all the local competition issues that Congress mandated.

The fact is, of the forty or so interconnection agreements that have been negotiated very few even address all fourteen items of the competitive checklist set forth

[4] H. Rep. No. 104–204, 104th Cong., 1st Sess., at p. 50 (emphasis added).

in Section 271 of the Act. Those that do fall short either in the pricing requirements of the Act, or by requiring certain restrictions on resale or unbundled elements.[5]

MCI and other new entrants have been forced to sign limited interim agreements to interconnect with the incumbent monopoly's network. Since these agreements are deficient, key elements—such as pricing terms for resale of local service—must be renegotiated. Because negotiations with the RBOCs have led nowhere, MCI and new competitors are forced to go to arbitration. MCI has filed for arbitration in 28 states. TCG, MFS and AT&T have all filed petitions requesting arbitration with the RBOCs.

A competitive marketplace naturally works against such anti-competitive abuses. When several vendors compete for MCI's business, they are responsive to our needs. But when MCI and other competitors must still rely on the monopoly RBOCs to reach our customers, bad things can happen. Consider these two examples:

*Bad Faith Dilatory Tactics.*—The RBOCs have used delaying tactics since passage of the Act to stifle competition. In April, we sent each RBOC (and each state commission) our Term Sheet, listing the items we needed from them in order to provide local service. The RBOCs' response was to refuse to talk to us without a gag order on the negotiations, forcing us to seek mediation. Recently, with the leadership of the Michigan Public Service Commission, Ameritech retreated from that position and has begun to talk to us. But, we spent from March to July without engaging in any serious pricing negotiations based on their unreasonable insistence on putting MCI under a gag order.

*Refusal to Negotiate.*—Bell Atlantic has refused to negotiate an interim agreement in New Jersey, despite agreeing to one in Pennsylvania. While we are ready to begin service and offer competitive choices to New Jersey customers, our switch there lays dormant because of Bell Atlantic's refusal to negotiate. Similar inconsistent positions have been taken in different states by US WEST and GTE. In addition, Bell Atlantic has refused to provide us with any pricing/costing information unless we agree not to disclose it to anybody.

Such behavior is not indicative of a competitive market. It represents the tried and true tactic of a monopolist—deter, disrupt, and delay. It is nothing but a flagrant attempt by the RBOCs to preserve their monopolies. If successful, these delaying tactics would mean that consumers would have to wait years for the benefits local competition will bring: lower prices, more choices and better service. This pro-monopoly behavior is inimical to the purposes of the Act and demonstrates the importance of regulators, both federal and state, managing the transition to competition. Before discussing the FCC's challenge in implementing the Act, I'll briefly describe the "navigational tools" regulators need.

NAVIGATIONAL TOOLS NEEDED TO JUMP START LOCAL COMPETITION

In the months ahead, regulation must play its role as a substitute for market forces until true competition arrives. Regulatory oversight is needed to ensure that the proper safeguards are in place during the transition from a single-provider monopoly market to a competitive one. Regulators should employ a simple and straightforward set of navigational aids to set the course toward true competition in local markets by asking, of each regulatory action: Does it create an environment that promotes investment and the development of an array of new services? Does it establish prices that mirror a fully competitive environment? Does it provide vigilant oversight against anti-competitive practices?

These are the navigational aids that will lead to open, competitive markets. Enforcement measures must be simple, yet allow for decisive and swift action by aggrieved parties (presumably new entrants). The measures should not require constant policing or modification and should incorporate incentives and disincentives for just and reasonable resolution of complaints. They must also allow state and federal regulators to render fair and unambiguous decisions that may be implemented without untoward delay or confusion. Vigilant oversight means:

*Establishing specific deadlines.*—For example, both the new entrant and the incumbent telephone company should know the number of days by which an order for unbundled network elements must be filled.

*Specifying what will—and will not—satisfy the rules.*—In other words, ambiguity in the rules will only serve to delay competition.

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[5] For example, MFS has signed Section 252 agreements with the following RBOCs: SBC, Ameritech, NYNEX, and Bell Atlantic. The agreements do address most issues but have shortcomings with respect to specific terms and conditions such as resale (restrictions apply; not priced based on avoided cost pricing, etc.) or access to network elements.

*Establishing and enforcing easily-calculable penalties for non-compliance.*—Parties should be clear that unacceptable actions will be met with inescapable and severe reactions. An adjudicatory proceeding bogged down with questions of intent and motivation is slow and arduous, which creates an incentive for delay. On the other hand, easily-applied sanctions that penalize unacceptable and discriminatory behavior will create the appropriate incentives for compliance. For example, pursuant to the Act, any carrier caught "slamming" will lose any charges that it unlawfully received. Similarly, any local competitor that fails to satisfy a customer's order to change his/her local service provider should also forfeit all charges assessed to the customer since submission of the order (including access charges). Ineffective enforcement in implementing rules will significantly delay local competition.

So far, the FCC has made a good start in its implementation of the Act, but many challenges lie ahead.

IMPLEMENTATION OF THE ACT: THE CRITICAL REGULATORY "TRILOGY"

Recognizing that the transition from monopoly to competition could not occur overnight, Congress established a detailed schedule and sequencing of key events in the Act that, over the next few years, have the potential for unleashing the full force of telecommunications competition on the U.S. economy. As Congress provided and the FCC has recognized, three events—the regulatory "trilogy"—form the cornerstone of future telecommunications policy:

*National Local Competition Rules.*—Adoption of national rules is needed to foster local competition throughout the U.S.

*Universal Service Reform.*—A competitively-neutral universal service plan that increases the number of Americans on the network, that provides affordable local service as well as access to basic and advanced services, that ensures that all carriers contribute on an equitable basis and that eliminates a system of hidden subsidies that are as outmoded as the rotary dial phone is necessary to achieve high levels of usage while denying monopolies corporate "welfare" payments.

*Access Charge Reform.*—Cost-based access prices are necessary to achieve the policy of bringing competition to all telecommunications sectors.

Like any literary trilogy, each part must not only stand on its own strength, but must also be viewed relative to the whole to be fully understood.

*The FCC's national local competition rules*

On August 1, the FCC completed its work on part one of this policy trilogy—its local competition rules. It passed those rules on to the state commissions for implementation as part of the negotiation and arbitration procedures to open local markets to new entrants. From MCI's perspective, the steps thus far, while not perfect, have been largely positive and pro-competitive:

*National Rules.*—While MCI will have to engage in state-by-state entry negotiations and arbitrations, we now have firm ground beneath our feet in the form of national rules that define a baseline of local competition requirements. States retain flexibility to add to the basic rules that the FCC outlined.

*Adoption of an Economic Cost Methodology.*—A forward-looking economic cost methodology is the hallmark of a competitive market and this is what the FCC selected. Such a model provides incumbent telephone companies with a reasonable profit and enables them to recover a share of joint and common costs.

*Default Prices.*—Even those states that lack resources to evaluate cost studies right away may jump start local competition. States remain in the "driver's seat" and can select their own prices consistent with the FCC's cost methodology.

The FCC still faces considerable challenges in completing the next two parts of the trilogy. In a competitive marketplace, there is no place for guaranteed profits and unneeded subsidies. Competition in both the local and long distance markets will be adversely affected if competitors are forced to pay incumbent monopolies outrageously inflated access charges that are seven times above the cost. Achieving competitively-neutral universal service reform and reducing access charges to cost are two necessary steps in truly moving forward the pro-competition agenda.

*The need for universal service reform*

Local competition rules will be effective only to the extent that the current system of local telephone subsidies is made rational, explicit, and available to all competitors.

*FCC adoption of competitively-neutral rules to promote competition.*—Current universal service subsidies, which are based on the local telephone company's historical costs, would protect it from the market discipline on its prices that competition should provide. As long as the universal service funding mechanism involves subsidies that are internal to the incumbent monopoly, potential competitive providers

of local service—even if more efficient—would find it difficult to compete with the incumbent.

*All carriers must pay into the fund.*—Universal service contributions should be made on an equitable basis by all providers of telecommunications services, based on their relative revenue shares, net of payments to other carriers. Recovering universal service support from all carriers would eliminate current incentives for carriers to avoid those services that pay for the universal service programs.

*Ensure affordability of local service.*—A competitive market will, over time, drive down today's above-cost price of local telephone service to economic cost. Today, the cost of serving low income consumers and customers in high cost areas likely exceeds rates that those customers are willing to pay or rates that regulators find acceptable. The universal service fund subsidies must bridge the "affordability gap" until competition drives prices sufficiently low. In addition, rates set at economic cost may be unaffordable for low-income consumers.

*The need for access charge reform*

As the FCC has recognized in other contexts,[6] the RBOCs have the ability and the incentive to squeeze their competitors by overcharging them for key inputs (i.e., access to the local networks to reach customers) that competitors need to originate and terminate calls. Given the size of the revenue generated from access charges—long distance company payments exceeded $23 billion in 1995—the RBOCs' incentives to act anticompetitively are significant and undeniable. MCI has filed studies with the FCC demonstrating that access charges today are approximately seven times their economic cost. The total interstate switched access charge is now about three cents per minute for the use of RBOC facilities which, according to Hatfield Associates, cost less than four-tenths of a cent per minute to provide.

Local access is the most lucrative line of business for the RBOCs, with margins about three and one-half times more than the long distance industry, helping to make the RBOCs among the wealthiest corporations in the world. They have the highest operating cash flow margins of any U.S. industry—greater than oil companies, electric utilities, and drug companies, and much greater than the long distance industry. Two companies with second quarter revenues similar to MCI's, GTE and BellSouth, are twice as profitable as MCI. The other RBOCs' margins are similar. Why? Because they operate in sheltered monopoly markets. They are rich enough to invest heavily in foreign telephone markets—and to offer premiums to acquire each other.

If the RBOCs were allowed to enter the long distance market before the access charge regime is reformed, the current outrageously high level of access charges would give them a tremendous—and tremendously unfair—advantage. Competitors can't be saddled with inflated access charges that subsidize the RBOCs' entry into long distance if real competition is to be created in local markets and retained in long distance. Even if an RBOC is required by law to "impute" the above-cost access payments (as the Act requires of an RBOC long distance affiliate), all the RBOC is doing is moving the money from its long distance side of the business to the access side of its business. The long distance business, to the extent it continues to rely on over-priced RBOC-provided access, would be imperiled. The only pro-competition solution requires that access charges be reduced to cost immediately. MCI would much rather give that money to our customers through lower rates than hand it over to the RBOCs. In fact, MCI has publicly committed to flow access reductions through to our customers and your constituents.

THE PROPOSED RBOC MERGERS WILL HARM COMPETITION

The recent announcements of two pending RBOC mergers are alarming and ought to be opposed. By choosing the route of consolidation rather than competition, SBC and PacTel, and Bell Atlantic and NYNEX provide further compelling evidence of their ambition to thwart the development of competition in their local monopoly markets. It is not coincidental that these mergers were announced only two months after passage of the Act. The new law significantly increased the vulnerability of each RBOC to competition in its core local markets and permitted each to offer out-of-region long distance services. That vulnerability and that opportunity created a clear and present danger that the RBOCs would actually compete with each other in local markets. Rather than compete in each other's markets, four RBOCs have announced their plans to consolidate and head off competition.

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[6] Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport, Report and Order, CC Docket No. 94–97, Phase I, 10 FCC Rcd 6403 (1995).

The mergers, if approved, will frustrate local competition. Indeed, the RBOCs specifically defend the proposed mergers principally on the ground that they will not reduce current levels of actual competition.[7] The mergers do nothing more than increase the number of local monopoly markets controlled by any single entity and, they argue, are therefore entirely inoffensive. This view rests on a fundamental misconception of the antitrust laws. Antitrust law is concerned not primarily with the status of competition now but, rather, with the outlook for competition in the future. The proper question is not whether the proposed mergers will make the markets less competitive (they couldn't possibly be), but whether they will stand in the way of making those markets more competitive.

*The mergers should be blocked under section 7 of the Clayton Act*

Antitrust law demands a dynamic, not static, analysis to answer such questions. A forward-looking analysis is especially crucial here because we are at the dawn of a new telecommunications era. There is no stable historical baseline against which to measure the likely competitive consequences of the proposed mergers. The relevant markets are characterized by rapid technological change, the dismantling of regulatory barriers to competition, and the imposition of federal policies specifically designed to open these markets to competition. Section 7 of the Clayton Act prohibits mergers when there is a reasonable probability that there would be less competition in a given market after a proposed merger than there would be absent the merger. In MCI's view, this is not a close call. It is extremely likely that local markets in SBC's, PacTel's, Bell Atlantic's, and NYNEX's regions will see markedly less competition in the foreseeable future if the mergers are consummated than if they are blocked. It is our hope and expectation that DOJ will advance the cause of competition, consistent with antitrust law, the 1996 Act and the interests of consumers nationwide, by moving to block these proposed consolidations.

Numerous factors, alone and collectively, will make realization of the Act's promise, particularly the development of local competition, substantially more difficult if the RBOCs are permitted to merge with each other. Briefly stated, the mergers would have several anti-competitive consequences in telecommunications markets, including (but not limited to):

*Eliminate Key Potential Local Competitors.*—Because the merging RBOCs would be very likely to enter each other's markets absent the proposed mergers, allowing the mergers will eliminate especially advantaged competitors.

*Diminish Opportunities for Non-RBOC Entry.*—By eliminating or reducing the prospects for competitive entry into one RBOC's territory by other RBOCs, the mergers also reduce the prospects for successful entry by non-RBOCs that would otherwise benefit from the pathbreaking efforts of the out-of-region RBOCs.

*Enhance Opportunity for Anticompetitive RBOC Coordination and Collusion.*—The mergers enhance the ability and incentive for the remaining RBOCs to collude in a strategy of mutual nonaggression, thereby entrenching existing anti-competitive market allocation.

*Increase Likelihood of RBOC Anticompetitive Harm in Local and Long Distance Markets.*—By capturing a significantly larger share of the access market in the combined regions, two "mega-RBOCs"—possessing bottleneck control of over 45 percent of the nation's phone lines—would substantially shrink the remaining market available to potential entrants. In addition, by increasing the number of long distance calls that originate and terminate entirely in-region, the mergers would enhance the "mega-RBOCs'" access charge advantage as well as their ability to effect nonprice discrimination against their long distance rivals, thereby strengthening their positions in the long distance market and, as a consequence, raising the barriers to successful entry into their monopoly local markets.

*Elimination of key potential competitors*

The mergers substantially reduce potential local competition. But for the mergers, RBOCs would be particularly likely to enter each other's market. It is essentially indisputable that Bell Atlantic and NYNEX would enter each other's markets to compete head-to-head if they were prevented from merging. As Bell Atlantic Chairman and CEO Raymond Smith noted noted in an announcement of the proposed Bell Atlantic acquisition of NYNEX, "[O]ur two regions are really one big market,

[7] See Joint Application of Pacific Telesis Group and SBC Communications Inc. To the California Public Utilities Commission, April 26, 1996.

with all the major urban areas up and down the east coast and lots of communities of interest."[8] Wall Street and newspaper analysts concurred.[9]

Similarly, SBC's foreign interests and aspirations provide substantial evidence that SBC was a likely entrant into PacTel's region. SBC's intentions of being a significant carrier of international traffic between the U.S. and Latin America and Asia cannot be achieved without a strong presence in California. Even more significant is SBC's ownership and control of Telmex, the Mexican telephone monopoly, that is frustrating efforts of new entrants to compete in Mexico. Because approximately 50 percent of U.S.-Mexico traffic originates and terminates in the combined SBC-PacTel regions, SBC's control over local markets in both regions would enable it to foreclose a substantially greater share of the U.S.-Mexico market that it could at present. An SBC-PacTel merger would solidify Telmex's power against its rivals to the detriment of U.S., consumers who call Mexico. SBC and PacTel acknowledge this in their application to the California PUC for approval, describing the California, Texas, Mexico region as a natural community of interest. In order to secure its control over this community, SBC would be compelled to challenge PacTel in California if it could not achieve the same result through merger.

The elimination of an RBOC as a competitor is significant given that they posses unique advantages. In particular, the RBOCs have large advantages in trained personnel, access to and knowledge of operational support systems, favorable treatment as large customers of vendors of switches and other telecommunications equipment, an existing relationships with large corporate customers. In addition to operational, architectural an experiential factors, the RBOCs enjoy substantial financial advantages over other potential local competitors. As noted earlier, the RBOCs are among the wealthiest corporations in the world and have the highest cash flow margins of any U.S. industry.

The RBOCs are not the only firms potentially capable of bringing competition to local monopoly markets, but they do posses unique resources that, if brought to bear out-of-region, would have a powerful effect on the development of local competition. Consumers in all four of these RBOC regions will feel the loss of potential entry that these mergers entail. These mergers will impede the development of competition in those local markets; prohibiting them will accelerate it. Under Section 7 of the Clayton Act, the choice is clear.

*Mergers diminish opportunity for non-RBOC local entry*

Insofar as the mergers eliminate one potential entrant from each of these four RBOCs' local markets and increase the likelihood that other RBOCs will forebear from entering those local markets, they also hamper entry by non-RBOCs by extinguishing a crucial source of pro-competitive pressure in each of these markets upon which those other potential competitors must rely. This is true for several reasons. First, an RBOC's inside knowledge of local network capabilities and limits gives it an unusual ability to achieve pro-competitive state regulatory action. Entrants to a local market are better able to rebut the potentially obstructionist arguments of the incumbent RBOC before a state PUC if the entrants' rank include another RBOC.

Second, an entering RBOC can be more effective in negotiations with the incumbent RBOC than other entrants because it knows that what technical capabilities the incumbent possesses. This will benefit all new entrants because, under section 252(i) of the Act, all entrants can avail themselves of the terms and conditions of an agreement made between the incumbent and any one the them. All entrants suffer when the strongest of potential entrants chooses not to enter. Thus, the reduction of RBOC competitors also dampens the competitive prospects for non-RBOCs.

*Mergers enhance opportunity for anticompetitive RBOC coordination and collusion*

The proposed mergers enhance the ability and the incentive for the remaining RBOCs to forbear from entering each other's markets, thereby entrenching and formalizing a territorial market allocation that exists as a result of the antitrust con-

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[8] Raymond W. Smith, Merger Announcement, Employee Video Conference (Bell Atlantic Media Relations Home Page)

[9] Analysts predicted that "each company's core business would be less susceptible to competitive entry because both Bell Atlantic and NYNEX would have likely been aggressive in attaching each others service territories given the geogrpahic proximity." Dean Witter, Bell Atlantic to Merge with NYNEX, April 22, 1996 (Guy W. Woodlief); see also Salomon Brother, Bell Atlantic/NYNEX Merger Creates Opportunity, April 22, 1996 (Jack B. Grubman). Press reports were similar: The April 22 Wall Street Journal reported that "Bell Atlantic and NYNEX * * * serve adjacent regions and could have turned into each other's worst competitive nightmare. By combining each eliminates a hearty rival * * *." The New York Times, of the same date, observed that "[A]s NYNEX gazes across the Hudson at the most aggressive Bell company in the country, merging now probable seems a lot more appealing than the prospect of fighting later."

sent decree that broke up the Bell System in 1984. Since divestiture, the RBOCs have carefully avoided competing in one another's core local exchange businesses. The 1996 Telecommunications Act has, however, eliminated those legal and regulatory barriers that may have dissuaded the RBOCs from competing against each other in the past. There should be a strong presumption here against extending the anticompetitive effects of this territorial allocation by, in effect, making those allocations permanent through mergers.

More generally, successful RBOC mutual non-aggression and forbearance from entry into one another's markets is much more likely with fewer competitors because coordination is easier.[10] The consequences of retaliation are more severe as the number of RBOCs decreases. Each has more to lose and an increased incentive to maintain the status quo. Additional RBOC consolidation, which these mergers will likely stimulate, further increases the prospects of coordinated territorial allocation.

Indeed, recent testimony by Bell Atlantic's own experts confirms this point. Alfred Kahn and William Taylor endorsed Bell Atlantic's proposed merger with TCI largely on the ground that the resulting entity's plan to bring facilities-based competition to other RBOCs would provoke the "mutual interpenetration of previously exclusive market territories" that appeared to be the most promising road to true competition.[11] The TCI merger was not consummated and three years later—within two months of the Act's enactment—Bell Atlantic proposes to merge with another RBOC, the most likely and formidable rival in its local markets, instead of competing head-to-head as it had earlier proposed.

*Mergers increase likelihood of anticompetitive harm in local and long distance markets*

The entry, upon authorization, of the "mega-RBOCs" into long distance will significantly inhibit the development of competition in the local market by shrinking the amount of access charges potentially available to other would-be entrants. The merged RBOCs will rely entirely on themselves to provide access to their long distance services within the merged region. Hence the shift of an important share of long distance traffic from independent long distance carriers to the RBOCs will reduce the potential business available to an independent local carrier. Because access revenues are such an important part of the local market—more than $23 billion in 1995—the reduced size of the local access market will substantially limit the incentive perceived by the potential entrant to the local market, thereby reducing both the number of and viability of local competitors. For example, if SBC does not merge with PacTel, then when SBC seeks to provide long distance service terminating in PacTel's region, it will shop for the most advantageous access pricing for terminating traffic. New local entrants that provide access would vigorously compete for SBC's business. The merger would remove SBC as a customer for those new competitors in PacTel's local market, making entry considerably more difficult.

The mergers solidify the proposed "mega-RBOCs'" power in the local markets by enhancing the strength they would exercise in the long distance markets if and when they are authorized to provide interLATA service. Because of its monopoly control over the bottleneck local loop, such an RBOC will have strong incentives to engage in non-price discrimination against its long distance rivals. The harm resulting from non-price discrimination against MCI and other long distance competitors were a principal justification for divestiture.[12]

RBOCs can discriminate in a number of ways; consider a few examples. An RBOC can refuse or delay interconnection on the basis of unsupported claims of technical infeasibility. Or an RBOC can provide degraded connections to competitors and selectively provide superior services to their own affiliates. An RBOC can discriminatorily use sensitive information MCI and others must provide when establishing new access arrangements. An RBOC can also refuse to develop access modifications we need, or delay such modifications to give its affiliate time to "catch up." One last example: an RBOC can make available services to its affiliate before releasing similar services to long distance competitors. In a variety of ways that are both highly effective and difficult for regulators to detect and police, the RBOCs can

[10] See, e.g., *Hospital Corp. of America* v. *FTC*, 807 F.2d 1381, 1387 (7th Cir. 1986) (Posner, J.), *cert. denied*, 481 U.S. 1038 (1987).

[11] Kahn & Taylor Affidavit, at para. 22.

[12] See *United States* v. *Western Electric Co.*, 900 F.2d 283,301 (D.C. Cir. 1990) ("BOC entry into the interexchange market * * * would of course provide an incentive to deny equal access and to cross-subsidize if possible"). *See also* Motion to Vacate, Affidavit of Jeffrey M. Perloff and Larry Karp (submitted in support of motion to vacate), ¶ 111 ("The major potential advantage that the RBOCs have in the long-distance market is through restricting access to other long-distance carriers.")

and will withhold the cooperation necessary to permit long distance competition to continue to flourish.

As discussed earlier, the RBOCs can engage in price discrimination against their long distance rivals as a result of the grossly inflated access charges. Both price and nonprice advantages are magnified on all long distance calls for which the RBOC controls the local bottleneck at not just one, but both, ends. The effect on the access charge advantage is straightforward: it doubles. The only pro-competition solution requires the reduction of access charges to cost.

MCI estimates indicate that the SBC-PacTel merger would increase the percentage of long distance calls that are wholly intra-region for those two carriers by approximately 20 percent. The proposed Bell Atlantic-NYNEX merger would produce even greater increases in intra-region traffic. The number of long distance calls originating and termination in Bell Atlantic's region would increase by nearly one-third and NYNEX would have about a 50 percent increase.

The mergers' effects on intra-region long distance are significant because the likelihood that any given customer will purchase its long distance service from its local RBOC increases in proportion to the percentage of that customer's long distance calls on which the RBOC can engage in price and nonprice discrimination at both ends. The mergers present a distinct threat to competition in the long distance markets in the Bell Atlantic, NYNEX, SBC, and PacTel regions.

The danger to local competition is even more acute because many customers will prefer to purchase their local and long distance services from a single carrier. Any mechanism that enhances the attractiveness of an RBOC's long distance service—whether or not that mechanism is anti-competitive—will make it harder for new entrants to woo the RBOC's customers away for the provision of local service. Insofar as customers value "one-stop shopping," every long distance customer that an RBOC captures raises the barrier to entry into the RBOC's local markets. Because those markets are already monopolies, a merger that increases an RBOC's ability to gain long distance customers is necessarily anti-competitive.

Each of the factors discussed above will make it more difficult for local competition to develop. Some will have a more substantial effect than others. Collectively, all these factors ensure that the mergers would have a profoundly negative effect on the development of local competitive and risk significant harm to the already competitive long distance market.

## CRITICAL ROLE OF DOJ IN PROMOTING COMPETITION

Mr. Chairman, the FCC's completion of the local competition regulatory "trilogy" and thorough DOJ scrutiny of pending RBOC mergers are critical to achieving the Act's goal of fully competitive telecommunications markets. The Act specifically recognized the appropriateness of DOJ's review of such mergers.

Equally important is DOJ's careful review of RBOC applications to enter the in-region long distance market under Section 271 of the Act. Premature RBOC entry would not only harm an already competitive long distance market, but would also impede the development of local competition. The RBOC's control of access to virtually every business and residential customer in their regions could be leveraged anticompetitively in both markets.

Before authorizing RBOC entry into the long distance market, the FCC, in consultation with DOJ, must establish that the petitioning RBOC has met the Section 271 competitive "checklist" of market-opening requirements and that the RBOC faces facilities-based competition for local services to both business and residential customers. In making its evaluation, Section 271 specifically states that DOJ may use any standard it considers appropriate and DOJ's evaluation must be accorded substantial weight by the FCC. As the guardian of our nation's competition policies, DOJ has the expertise and experience necessary to protect consumers and competitors from the anticompetitive conduct of the RBOC monopolies. MCI again acknowledges the leadership of many members of this Committee for ensuring that the Act includes an appropriately important role for DOJ.

## CONCLUSION

Mr. Chairman and members of the Committee, the Telecommunications Act of 1996 provides an historic framework that may unleash virtually unlimited opportunities for companies to provide new services in environment replete with customer choice both in features and price. The details of how the framework is implemented, however, are critical. The result will either pave the road to competition or will provide an impenetrable roadblock. The FCC must complete the regulatory trilogy and the DOJ must stand guard against anticompetitive proposed activities.

Last month, the FCC made a good start when it issued the local competitive rules. Early next year, it will complete the trilogy by issuing regulations implementing needed reforms on universal service and on access charges. The Act calls for a competitively neutral universal service mechanism. The subsidies that all competitors will pay to this fund must be equitable and explicit and must be coupled and reform of the existing access charge system which presently requires some potential competitors to pay charges that are seven times above the RBOC's actual cost. Both of these rulemakings are critical to ensure that no one player in the marketplace—especially an incumbent monopoly—is at a significant, unfair advantage to its rivals.

Of equal importance, the DOJ must continue to play its traditional role as the guardian against anticompetitive economic activities in this country. The members of this Committee are to be commended for insisting that the final legislation included an important and appropriate role for the DOJ in reviewing RBOC entry applications. Together with the DOJ's long-standing antitrust role, this is critical to ensuring that competition in the telecommunication field will flourish. Proposed monopoly mergers, such as those envisioned by Bell Atlantic and NYNEX and SBC and PacTel are the antithesis of competitive that the legislation envisioned. The Act did not envision the growth and consolidation of existing monopolies, but rather the opening of monopoly markets.

Mr. Chairman, I appreciate having the opportunity to testify today. I applaud the Committee for its attention to and oversight of these important competition issues.

Senator THURMOND. Mr. Barr.

## STATEMENT OF WILLIAM P. BARR

Mr. BARR. Thank you, Mr. Chairman. I am privileged to appear here today before the committee. As you know, I represent GTE Corp., and in a way we don't have a dog in this fight because we are not involved in a merger. We are a local exchange company. We are not part of the Bell group. We operate in 28 States, and after the legislation has passed we have now started offering long distance. We are in 20 States offering long distance, adding 6,000 customers a day to that line of business.

In addition, we have filed to compete against other LECs. In Texas, we have filed to compete against Southwestern Bell. In California, we have filed to compete against PacTel, and we have filed to compete in Virginia and Pennsylvania against Bell Atlantic. So from a narrow business perspective, it is not in GTE's interest to see these two mergers occur, to the extent that they create more formidable competitors for us. But we are not here to plead a special case and try to derail potential competitors. What we are trying to do is help this committee's assessment of the antitrust implications of these mergers.

I see no basis for concern from an antitrust standpoint. Clearly, as far as the local exchange is concerned, the proper analysis is for potential competitors, and I have heard the four companies involved saying they did not have plans and I take them at face value, and certainly the Justice Department will review the documentation. But even that is not the critical issue. The critical issue is whether or not they are singularly suited and uniquely qualified to be the principal competition of each other, and that clearly is not met.

The test really is, does the prospect of developing competition up in NYNEX's market rest really on the shoulders of Bell Atlantic, and to suggest that it does is simply nonsense. It has no bearing in the real world. There are numerous existing entrants already and there are numerous potential entrants that pose a far greater competition threat to NYNEX and Bell Atlantic than those two companies do, and the same with respect to SBC.

As far as the interLATA market is concerned, the argument really is another dusted-off version of the antiquated bottleneck argument that somehow they will unfairly leverage their position in the local market to gain advantage in interLATA. Let me just say that now that we have equal access in effect, now that we do have emerging competition, and now, on top of those things, that we have a 14-point checklist that the RBOC's have to meet before they are allowed into long distance, that argument of the bottleneck really evaporates. We are not talking about a bottleneck anymore.

Let me just say that there has been some skepticism about whether or not there is actual competition in the local market, and I would like to use Senator Leahy's example because I think it really offers a very good illustration.

The fact is, Senator, here on Capitol Hill you do have a choice of what phone to use. I was very amused that Mr. Ebbers was sitting here acting as if there was no local competition. This is a very profitable center here, Capitol Hill. You can imagine all the calls that are made from here. Well, the fact is Bell Atlantic doesn't serve it. It was taken away by MFS. It is being served by a CAP. That is where the margin is, that is where the competition is.

Now, up in Vermont, I don't know for a fact, but I would bet that you are being subsidized, that the money you pay every month for local phone service is not covering the cost. The person who is picking up the difference is a business in Vermont, such as Ben and Jerry's, and I bet you right now Ben and Jerry's has a choice and I bet you there are CAP's and they are trying to get Ben and Jerry's business. No one is interested in your business, Senator, because you are not paying costs.

Senator LEAHY. Both Ben and Jerry can afford it a lot better than I can. [Laughter.]

Mr. BARR. OK. Let me just say that I think the overall point shouldn't be lost. I think we are in a time warp, and my overarching concern about how you are looking at telecom deals is don't get locked in the mindframe of 1984 and the theoretical problems that were identified then. Look at what is happening today, and, I think, when you see what the FCC order, it is a radical overturning of what Congress tried to do in the Telecommunications Act.

What it does is it says that—where Congress said that when people come in and try to set up competition and set up facilities and they want to piece together a network, they have to pay the cost to the incumbent facility-based LEC, the FCC has come along and said, no, you are able to pay a very deep discount, more than 40 percent, for their facilities. This really converts the local exchange company into a wholesale platform, and when you look at who is going to be powerful in the game of packaging services that are essentially bought from a wholesale provider and labeling them, it is the companies with the brand names and the customers, and those companies are the IXE's principally right now.

With that, I will stop my prepared remarks.

[The prepared statement of Mr. Barr follows:]

PREPARED STATEMENT OF WILLIAM P. BARR

I appreciate the opportunity to offer my views on the important topic before this Committee today, and I thank Chairman Hatch and the other members of the Committee for inviting me to appear.

Let me begin by noting that GTE currently provides wireline local exchange service in 28 States and wireless service in 16 States. The States that GTE serves includes States that will be part of the combined Bell Atlantic-NYNEX region, States that will be part of the combined SBC-Pacific region, and local service areas in which LDDS Worldcom-MFS is or will be competing. Presumably, these mergers are being undertaken because the merging parties believe that they will garner efficiencies from merging. To the extent that the mergers make them more effective competitors, it is not in GTE's interest to welcome any of these three mergers. The question being addressed by this Committee, though, is whether any of these mergers presents serious antitrust concerns, and, as the general observations that I will outline indicate, I believe that it is clear that they do not present any such concerns.

I have four general—and interrelated—observations that I believe ought to inform antitrust analysis in the telecommunications industry today:

1. In many places, and especially in key markets, the so-called local bottleneck, on which so much of antitrust regulation of local exchange carriers was premised, has been opened up wide. In enacting the landmark Telecommunications Act of 1996, Congress recognized what the marketplace has shown: the local exchange market is, in many places, no longer characterized by the economics of natural monopoly. In other words, competing local carriers can profitably enter the market and provide services to the consumer. Therefore, the traditional antitrust concern that a local exchange carrier might leverage its power in the local exchange market into other product markets has been dramatically lessened.

2. In addition to actual new entrants in the local marketplace, there is a legion of powerful potential new entrants, including those entities currently operating as interexchange carriers, competitive access providers, and wireless providers. In short, an incumbent LEC serving an attractive service area faces a broad array of competitive threats. While an adjacent LEC—that is, a LEC serving an adjacent service area—may also be a potential entrant, there is no reason to believe that such a LEC has any significant overall advantage over other entrants, and there is therefore no reason to believe that the competitive threat from that adjacent LEC's actual or potential entry will significantly affect the development of competition.

3. Local exchange carriers are subject to pervasive regulation by both the FCC and state public utilities commissions. Such regulation is more than adequate to prevent and detect any anticompetitive abuses by local exchange carriers. Indeed, the real danger to competition is that excessive, onerous regulation will prevent incumbent local exchange carriers from competing on a level playing field with the new entrants. The Federal Communications Commission's recent rules purporting to implement the Telecommunications Act of 1996 highlight this danger. Contrary to the pro-comeptitive, deregulatory intent of Congress in enacting the Act, the 668 pages and 3,276 footnotes of the FCC's First Report and Order require incumbent LECs to subsidize their competitors through below-cost pricing and force incumbent LECs to operate their networks for the benefit of competitors. Under the FCC's system, it make no sense for any competitor to develop its own network. Instead of real competition that spurs investment, creates jobs, and improves services, the end result of the FCC's rules will be a scheme of contrived "Potemkin competition" in which so-called competitors merely rebrand services purchased below-cost from a severely handicapped incumbent LEC and create the false appearance of competition.

4. Recent academic research strongly indicates that the long-distance market is currently characterized by oligopolistic pricing by the three leading interexchange carriers (AT&T, MCI, and Sprint). To the extent that any merger increases the prospect for vigorous competition in the long-distance market in the long run, it ought to be viewed very favorably by antitrust authorities.

What all of these observations together suggest is that the proper role of antitrust with respect to mergers and acquisitions of local exchange carriers will be a limited one. Such transactions will not typically present any serious antitrust concerns, and one ought especially to be highly skeptical when such concerns are voiced by powerful industry competitors.

Senator THURMOND. We will be glad to hear from you, Mr. Atkinson.

## STATEMENT OF ROBERT C. ATKINSON

Mr. ATKINSON. Thank you, Senator Thurmond and Senator Leahy. Teleport Communications Group [TCG] is pleased to testify

today on the impact of mergers of Bell operating companies on local exchange competition.

As background, TCG is the Nation's leading competitive local exchange carrier, or CLEC. We operate in California in competition with Pacific Telesis, in Texas and Missouri in competition with Southwestern Bell, and in most of the States in the NYNEX and Bell Atlantic regions. From 10 years of experience, we draw the following conclusions about these mergers.

The BOC mergers, we believe, will cause chaos, confusion, and distraction within the resulting Big Bell, leading to substantially worse operational performance by that Big Bell. In particular, service intervals, quality and reliability are likely to deteriorate substantially, at least for a number of years. This will be terrible for all consumers.

Ironically, because BOC's will continue to control unique essential services and facilities for the foreseeable future, CLEC's are becoming more dependent on the performance of the BOC as they grow and expand. Consumers hold CLEC's accountable when a BOC service or facility used by the CLEC fails. Consequently, a substantial deterioration of a Big Bell's operational performance will increase a CLEC's costs, hurt its reputation, and impair the CLEC's ability to compete effectively and to provide consumers with an alternative to the Big Bell's poor retail services.

The Telecommunications Act requires a BOC to provide competitors with performance quality no worse than it provides to itself, but this is not a competitive safeguard if the BOC's quality is deteriorating. Moreover, traditional regulatory processes have proven to be very inadequate for encouraging BOC's to provide high-quality services to competitors.

CLEC's and consumers should not be dragged down if the Big Bell's performance goes down. Therefore, as a minimum, BOC mergers should be conditioned on the Big Bell maintaining operational performance for CLEC interconnections at levels no worse than today's mediocre performance. Of course, a condition requiring steadily improving BOC performance in providing interconnections would promote better service to consumers and more effective competition.

BOC's must be subject to swift, certain and substantial penalties for imposing poor performance on their competitors. A BOC that does not expect its service to deteriorate as a result of the merger should not object to a condition requiring only the status quo. But opposition to such a condition implies that the Big Bell expects its performance to deteriorate or that it intends to use its control of essential monopoly network elements to competitively disadvantage CLEC's. Alleged consumer benefits of BOC mergers cannot occur so long as CLEC's are subject to anticompetitive behavior on the part of the Big Bell. The existing monopoly will simply become further entrenched if a Big Bell is permitted to control its competitor's service quality and costs.

Thank you for allowing me to make these brief remarks and I look forward to responding to your questions.

[The prepared statement of Mr. Atkinson follows:]

PREPARED STATEMENT OF ROBERT C. ATKINSON

Good morning Chairman Hatch and members of the committee. TCG is pleased to testify today on the key subject of mergers and competition. I am Bob Atkinson, TCG's Senior Vice President for Legal, Regulatory and External Affairs. TCG is the nation's leading competitive local exchange carrier, serving 51 major markets with state-of-the art fiber optic backbone networks supplemented by wireless facilities. We provide local exchange access services to long distance carriers, intra-LATA toll service, and switched local exchange services. We do business in California in competition with Pacific Telesis, in Texas and Missouri in competition with Southwestern Bell, and in most of the states in NYNEX and Bell Atlantic's regions.

My message is very simple. Mergers are desirable if consumer benefits result. Mergers of two giant telecommunications companies each having 99% of their market are not likely to benefit consumers so long as the relevant markets remain monopolized.

TCG is a company that has begun to "demonopolize" the markets of every Bell Operating Company (BOC). TCG can do this quickly if the BOCs—and especially any merged BOCs—are compelled to treat TCG in a pro-competitive manner, all the time, forever. The way to assure this was explicitly recognized in the Telecommunications Act of 1996: The incumbent local exchange carriers, who must now interconnect with their competitors, must treat their competitors at least as well as they treat themselves. [Sec. 251(c)(2)(C)][1]. TCG therefore believes that any BOC merger should be conditioned on the observance by the BOCs of explicit performance standards in making their essential facilities available to competitors. The standards must have teeth in them, so that the BOCs will have the financial incentives to achieve them.

The proposed mergers of Bell Atlantic with NYNEX and Pacific Telesis with SBC, like any mergers of huge corporations, initially are going to create chaos in those corporations. There can be no doubt that the BOCs will be distracted from their daily operations as they blend their disparate corporate cultures, operation support systems, billing systems, etc. Inevitably following a restructuring of such magnitude, employees will be focussed on internal concerns. In a truly competitive market, TCG might in fact be advantaged by the resulting chaos, to the extent that it will diminish our rivals' ability to provide good local exchange and exchange access service to its customers. But, the local telecommunications markets are not fully competitive, and one consequence of chaos within the BOCs could be very damaging to TCG: It will make it even more difficult for the huge entity of the merged BOCs—I'll call them the "Big Bells"—to provide good service to TCG.

I know this will be a problem post merger, because it is a problem now. TCG already has had years of bad experience in interconnecting with BOCs, particularly NYNEX and SBC. They fail to turn up circuits on time, they fail to complete construction on time, they fail to deal with trouble reports on time.[2] I believe that BOCs post merger, will be even less likely to make it easy for their competitors to obtain from them in a timely fashion the essential network facilities the competitors must have in order to compete with them. The potential harm to TCG caused by such failure is greater as TCG expands its switched business.

Contrary to what you might expect, this expansion, which requires the interconnection of more and more TCG facilities with BOC facilities, will for a transition period make all supposedly competitive local exchange carriers more, not less, dependent on BOC service quality. The technology and capabilities of incumbent LECs will become more, not less, critical to TCG. When a BOC fails to turn up a circuit, TCG customers blames TCG, not the BOC. The chain of telecommunications service in our world of interconnected networks is only as strong as its weakest link. TCG backs it reputation as the carrier with the highest possible service quality by monetary guarantees to our customers—if our service quality falls below the standard we promise, we don't charge the customer. If the BOC link in the chain fails, TCG suffers financially and our reputation can also be impaired.

The BOCs' ability to raise their rivals' costs through delay and error is the greatest threat to full competition in the local exchange market. This may be intentional, or it may be accidental, but whatever the cause, the effect is anticompetitive. This ability is not constrained at all now. Although TCG has complained to both state

[1] An incumbent LEC has the "duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection that is at least equal in quality to that provided by the local exchange carrier to itself or to any subsidiary, affiliate, or any other party to which the carrier provides interconnection * * *"

[2] For example, Between March 1996 and July 1996, despite assurances from NYNEX that performance would improve, it did not. Of the six performance measures that TCG monitors quarterly, all but one were rated Unacceptable, compared to objectives set by TCG and NYNEX.

and federal regulators, the plain fact is that regulators, given the procedures they are legally required to follow, cannot fix TCG's problems quickly enough to mitigate all the harm that a BOC can cause TCG. Since Big Bells will have a much, much larger pie at stake,[3] after the proposed mergers, their incentive to continue dilatory behavior and foist inefficiencies on their competitors can only increase.

Interconnection agreements between BOCs and competitive local exchange carriers may provide such safeguards, but the BOCs, once they have merged, and once they have achieved entry into the interLATA market, will lack any incentive to honor the agreements. SBC, Pacific Telesis, NYNEX and Bell Atlantic know from experience, that the traditional regulatory process is completely ineffective when it comes to compelling them to treat competitors fairly. Thus, it is clear that the BOC mergers must be subject to a reasonable safeguard outside the traditional regulatory process to prevent such anticompetitive conduct.

The merging BOCs should enter into a Consent Decree providing for significant performance standards, together with meaningful penalties for their failure to meet the standards. The BOC must, by the intent of Congress, offer and interconnecting local exchange carrier service quality at least as good as what it offers itself. As required by the FCC ruling in Docket 96–98, standards assuring high quality in interconnection and interoperability must be referenced to the internal standards of the BOC. They must be subject to objective measurement.

Because we believe that the disruptions of the mergers will cause the BOCs' own internal performance to deteriorate, it is not good enough to reference the internal standards of the Big Bell after the merger. Rather, at least the standard realized prior to the filing of the Hart-Scott-Rodino request should be provided to TCG. Then Big Bell's service to TCG can't get worse, post merger, if the internal reference standards of Big Bell get worse. When Big Bell's service quality improves above that pre-merger level, TCG and all other interconnecting local carriers should receive the same quality.

If the BOCs claim, as they are now doing in the context of negotiations with TCG, that they have no such internal standards, then they have to develop them. The BOCs do have standards for service to their customers, and since the Act also requires that the quality of service offered CLECs must also be at least as good as what it offers any other carrier or any customer, they can adapt those to their internal practices as well.

But a standard is meaningless if failure to meet it results in a slap on the wrist. We have seen how ineffectual public utility commissions' fines for poor retail service have been: the BOCs pay the penalty, and make another promise, but service doesn't get any better. The same behavior cannot be allowed with respect to peer carrier service, for the result would be to curtail the opportunity for the peer carriers like TCG to protect the public from monopoly abuse by developing alternative networks and service offerings. Thus, a BOC or a Big Bell must face a hefty penalty if it fails to meet its performance standard. The penalty amount should grow larger for each incidence of the same failure. A Big Bell should be subject to at least twice the penalty of either of the merging BOCs would have been subject to, to reflect the greater value to Big Bell of impairing rivals' service over a much larger territory.

I have attached an illustrative list of minimum standards that TCG believes to be reasonable and appropriate.

How could a company of good intention object to this proposal? If the Big Bell—or any BOC, for that matter—intends to live up to the requirements of the Telecommunications Act, it should have no difficulty in committing to strict performance standards. If the Big Bell intends to meet the standards, and intends to incent its employees so that they will treat competitors as well as they treat themselves or other customers, the Big Bell should be perfectly willing to enter into such a Consent Decree. And if a Big Bell opposes tough performance standards in a Consent Decree, doesn't that show the Big Bell's intent to use its control of essential monopoly network elements to competitively disadvantage its peer local exchange carriers?

Mr. Chairman, I have only one other suggested condition for any BOC mergers. As a threshold matter, all of the conditions required by the Act for BOC entry into the interLATA market should be satisfied before a merger is approved. The Section 271 requirements speak the Congressional intent that BOCs not be allowed to expand vertically until local markets are arguably open to competition. The BOC mergers are in essence vertical expansions from a geographical standpoint.

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[3] To put the size of the proposed Big Bells into perspective, consider that Bell Atlantic and NYNEX will have, in local telecommunications alone, approximately 40 million access lines, revenues of nearly $24 billion—apparoximately 25% of the approximately $100 billion national revenues from local telecommunications—and EBITDA of over $11 billion.

In conclusion, TCG is entering new markets. We are adding switches at an impressive clip. We have signed interconnection agreements—pursuant to the Telecommunications Act of 1996—with two of the BOCs that are subjects of proposed mergers: NYNEX in New York, and Pacific Telesis. (Notably, however, the merger partner of each of these BOCs has been totally unwilling to enter into a negotiated agreement.) By November 8 we will have a negotiated or arbitrated agreements with all of the BOCs. Thereafter, TCG will be able to plan ahead with better knowledge of its monetary costs for interconnection and for use of BOC or merged BOC network elements. But, TCG should not have to plan for the costs of substandard performance quality in providing those essential functions and capabilities.

Thank you for the opportunity to present TCG's view.

ATTACHMENT 1.—INTERCONNECTION PERFORMANCE MONITORING

(For illustrative purposes only)

For each type of facility, Performance Standards should be set for:

*Installation*

Number of Installs
Time taken for Install
Percent on time

*Quality of Service*

Number of Failures
Percent Availability
Mean Time to Repair

*Grade of Service*

Bit Error Rate
Blocking Rate

ATTACHMENT 2.—SUMMARY OF NYNEX PERFORMANCE FOR TCG (JAN. 1994–MARCH, 1996)

Three Examples of "Report Cards" maintained by TCG to measure the performance quality of the BOCs with whom TCG interconnects:

Private Line Percent Availability—Declined;
Private Line Failure Rate—Increased;
Mean Time to Repair—Increased.

In addition to the above, performance measures in TCG's current report card are:

Scheduled Dispatches for Repair;
Pro-Active Status Updates when Outages Occur;
Service Improvement Plan;
Escalation Call Backs.

Senator THURMOND. Thank you very much. We thank all of you for coming.

Now, we will ask questions and each Senator will have 7 minutes.

Would each of you please give us your views on concerns raised about whether effective local competition will ever develop for business and residential customers, despite the best efforts of the Congress?

Mr. SALSBURY. Senator, I do believe that effective local competition will develop, first, for businesses and then for residential customers. I think it took about 10 years in the long distance industry. It probably will take a similar time in the local industry, maybe shorter because of some technological innovations that are coming along, but I do believe it will enter.

It is a fantastically lucrative market right now. If you compare the local market, which is around $100 billion in revenues and about a 50-percent profit margin, to the long distance market, which is smaller and about $75 or $80 billion and only has about a 15-percent profit margin, we look forward to entering it and we want to do it as quickly as we can.

Senator THURMOND. Mr. Barr.

Mr. BARR. Mr. Chairman, prior to the enactment of the Telecom Act, the main inhibition, I think, were the built-in subsidies. There is competition for business traffic. There won't be substantial competition for residential traffic until there is rebalancing of rates. Congress' law, I think, did promise substantial competition, or accelerating competition across the board, but I think it has been sabotaged by the FCC.

My concern is that what you will see develop in the local market is the incumbent LEC relegated to a wholesaler, unable to compete as a retailer because they have to provide every service, every efficiency they gain at a very substantial discount below cost. Then what will happen is the IXEs, who are essentially in a oligopolistic market at this point, can use their power to come in and replicate that in the local loop and this is how it will occur.

We have to remember that AT&T, for example, has more customers than the RBOC's combined. This isn't like MCI trying to scratch its way into AT&T's business. These customers are sitting there inside each RBOC's territory, and my concern is that when they are able to have the brand name that they do, which is a legacy of the monopoly in the first place, and they are able to retail facilities at a substantial discount below cost, they are going to be able to seize market share really based on that market power that they have developed as a result of their prior monopoly and because of their position in the long distance market.

Senator THURMOND. Mr. Atkinson.

Mr. ATKINSON. Thank you, Senator. I think you have to distinguish between resale competition and facilities-based competition. I think it is clear that in the immediate future you will see lots of resale competition, but that is pretty illusory kind of competition because a reseller who is simply just reselling the incumbent RBOC's services has effectively become a sales agent for the RBOC, not a competitor.

Facilities-based competition, on the other hand, is what leads to the substantial consumer benefits of competition because that is what really puts pressure on the incumbent. The development of facilities-based local exchange competition is going to take quite a few years simply because it takes a long time to deploy facilities ubiquitously up and down every street in every community across the country.

Nevertheless, I am quite optimistic that even the facilities-based local exchange competition will develop, but that will be perhaps as long as a decade from now. In the meantime, I think policymakers particularly have to be not misled by the apparent resale competition and mistake that resale competition for facilities-based competition.

Senator THURMOND. Mr. Salsbury, what similarities or differences do you see between MCI's early efforts to break into the monopoly long distance market and your current efforts to break into monopoly local markets?

Mr. SALSBURY. Well, right off the bat, Senator, I can see I have a lot more enemies than I did before. I only had one before. I think the big difference is that we were able, once the MFJ came about, to confront a dominant supplier that had no underlying physical

reason for its dominance. In other words, AT&T had a market share in excess of 90 percent, but it was not because of the facilities or anything else that they owned and it was relatively simple to replicate the network that AT&T had. It took a number of years and a lot of money, but there were not any real barriers to doing that.

This situation where we confront in the local business companies that are well entrenched, that have a far higher asset base and investment than AT&T did—it is very difficult to replicate any of their facilities. It often entails digging up streets and it takes a lot of time and a lot of money, and we have an entrenched group of monopolists that are very opposed to that competition.

I smiled when I heard Mr. Barr twice talk about we are trying to relegate them to the role of wholesalers. I don't really know what he thinks happens in the long distance industry. We are wholesalers and, in fact, Mr. Barr's own company is providing long distance service by reselling what they buy at wholesale from Mr. Ebbers' company. They get discounts of 80 or 90 percent from us and it hasn't seemed to bother us at all. That is competition.

Senator THURMOND. Mr. Barr, you stated in your written testimony that more efficient competitors are not in the interest of GTE. Does GTE expect any of the merging Bell companies to start offering local phone service in competition with GTE in any of the regions GTE serves?

Mr. BARR. Well, as I said, Senator, we have already filed to go into their territory and they have filed to come into our territory. So I think it is safe to assume that that reflects some potential direct competition outside our existing franchise.

To follow up on a point that Mr. Atkinson made, because I completely agree with him, the critical thing is getting facilities-based competition. That is absolutely essential. People should not be deceived by reseller competition. There is nothing wrong with reselling, there is nothing wrong with wholesaling, but if you set the prices so low, which the FCC has done—the FCC says that they are pricing our system based on the best technology that could be put into place and the most efficient design that could be put into place today.

Well, if that is the case, why would anyone want to invest their own money in those facilities if they can buy them so cheap from the incumbent LEC? What you get then is potential competition, not real competition, and that is our concern. So I agree more with Mr. Atkinson's point that it is important to foster facilities-based, and I was very amused when the FCC came out and they were asked specifically at the press conference whether their order discourages facilities-based competition or encourages it and they couldn't come up with the answer. I understand now they finally have an answer, which is we didn't know Congress wanted us to encourage facilities-based competition, as if there is any other kind of competition.

Senator THURMOND. My time is up.

Senator Leahy.

Senator LEAHY. Thank you, Mr. Chairman. General Barr, good to have you back here.

Mr. BARR. Thank you.

Senator LEAHY. You probably have spent more time in your life before this committee, or parts of it, than you would like to think about, but it has always been helpful to the committee when you have been here.

Mr. BARR. Thank you.

Senator LEAHY. Could I go into the Ben and Jerry's versus the Leahy household, because I find that kind of intriguing? I hate to tell you how many lines I have coming into my old farm house up in Vermont, between the Senate switchboard and the fax machines and computers and everything else, but there is no question that Ben and Jerry's, 5 or 6 miles from where I live, have it a lot different.

I ask this because the Vermont Public Service Board issued a report in January talking about competition and what it might do, and they said that residential rates might go up as much as $10 per household per month to make up for the increased competition and the lower rates for business. We are a rural State and for most people that would be a big bite.

Could you comment on what you might see happening to rural rates, or rates in rural areas like Vermont, with something like the NYNEX-Bell Atlantic merger, or in my State or elsewhere? I am asking the same question, really, of Mr. Salsbury and Mr. Atkinson.

Mr. BARR. I don't see the Bell Atlantic-NYNEX merger really affecting it. I think that what has to happen and what is not happening now is there has to be a decision on universal service which allows for the rebalancing of rates, but then protects the rural customer against paying unaffordable amounts by providing an explicit and rational system of subsidies that everyone contributes to so the local company is not the only one subsidizing the rural customer and therefore having a disadvantage so someone can come in and skim the cream.

So we need that universal service issue addressed to protect the rural customer as we rebalance rates to make sure they are not paying more than an affordable amount. Moreover, the statute has in it a rural exemption. I think you may have been among those to support it.

Senator LEAHY. Yes.

Mr. BARR. We certainly support it because we have a lot of rural properties.

Senator LEAHY. I was a supporter of that.

Mr. BARR. Right, and GTE in many of the States is a very rural company, and that provides an additional protection so that the local decisionmaker, the State, can make sure that jump-starting competition is balanced with the interests of the rural customer. But I think we have to get very quickly to the issue of universal service, how much do we expect people to afford. Let's get an explicit subsidy in place, because I think you can see right now until that is done, the local exchange company is operating at a tremendous and unfair disadvantage because we rely on the subsidy paid by Ben and Jerry, but then MFS can come along and just take them away because they don't have to rely on that subsidy.

Senator LEAHY. Mr. Salsbury, do you agree with General Barr?

Mr. SALSBURY. Some of the things he said. I do agree that for certain customers, I would say that it depends, of course, on population density, how far you are from the serving telephone central office; the length of the local loop, which is the primary cost element in your local telephone service. For customers in less dense areas who are a long distance away, usually a population density of around one person per mile, those customers will need universal service support in order to have their telephone service brought down to the national average, which is, I think, somewhere between $18 and $20 per month.

I think most of the other customers already today—local services is more than compensatory. I would expect the rebalancing that Mr. Barr spoke about to really involve a lowering of rates, certainly very substantially for business customers, and certainly for residential customers, too. They have been paying too much for too long. But this will follow from the universal service reform.

I would add, Senator, that the act really gives three ways for local competition to develop. It is very clear on that. One is resale, one is the use of unbundled network elements, and one is facilities-based competition, construction of new facilities. I know Mr. Barr and Mr. Atkinson have focused on the last one, but the other two are certainly fully legitimate and are the ways that one would enter the market on a mass basis quickly. They provide the most hope for residential customers in the near term.

The wonderful thing about competition, Senator, is that people are very inventive when they see a big pot of money on the table, and that is what local telephone service is. Right now, the overall profit margins for local service are around 35 percent. That is quite a good deal higher than they are for long distance and we are anxious to get in that area. I would certainly assume that rural areas would have competition more slowly than the urban areas, but I certainly think it will be there.

Senator LEAHY. Mr. Atkinson, what do you feel?

Mr. ATKINSON. I think that universal service proceeding at the FCC certainly is a very important step to making sure that rural consumers continue to get high quality service. As long as the rural consumer effectively has access to that subsidy and can direct that subsidy to any carrier, I would expect a dramatic increase in the number of entrepreneurial high technology companies that actually go to rural areas to pursue the subsidy amount and to introduce new technologies that lower the cost and improve the performance of rural telephone service. So I think an open universal service system will be a magic key to bring better quality and lower-cost service to rural areas.

Senator LEAHY. The Bell companies under the law have some interconnection and unbundling requirements. Now, I assume if the Bell companies start merging, they are going to be focusing a lot on that merger. Does that interfere in any way with carrying out their obligations, some regulatory, some contractual, to opening up a local loop?

Mr. ATKINSON. Well, certainly, that is the gist of my testimony, Senator. Based on our experience, over the 10 years that our company has been in business, we have been dealing with the Bell companies and periodically they reorganize internally and have dif-

ferent departments do different things. And every time they have an internal reorganization, their performance, their quality, their responsiveness to us falls on the floor.

I just have to imagine that something as huge as merging these two companies will exacerbate those historic bureaucratic problems to the point where it may make unbundled loops totally unusable because every unbundled loop is going to have to be hooked up and an order placed and processed by the telephone company, and if just the bureaucratic problems, the operations support systems that have to be merged and all those problems just inevitably are going to develop, unbundled loops and unbundled elements become actually unusable and worthless, and that impairs the development of the local exchange competition and that is a serious problem. That is why our suggestion is that at least the mergers should not go forward unless the BOC's are willing to guarantee that they will maintain the existing level of service.

Mr. BARR. Can I follow up briefly on that, Senator? I think it would create greater incentive for the RBOCs to meet their checklist so they can move into the long distance market. I mean, they are going to be focused on that because right now that is the carrot hanging out there for them. So I don't think it will inhibit them from carrying out those obligations.

I think that we can't lose sight of some basic realities in the marketplace, and Jim Young talked about this. You ask 10 people who their local telephone company is. Probably four will say it is AT&T. Even before AT&T got into wireless, when you asked people who the best wireless company was, 6 out of 10 said it was AT&T, before AT&T was even in the wireless business. AT&T has a massive brand and you can't lose sight of the fact that that is the legacy of the monopoly.

They also have customers—60 percent of the customers in our territory and in the RBOC's territory are AT&T customers. You may be an AT&T customer, Senator. When you get a letter from AT&T—and it is this simple—if you got a letter from AT&T that said you don't need two bills anymore, we are not going to send you a separate long distance bill, we will give you everything on this one AT&T bill, and then you got one from your local carrier saying the same thing, what makes the local carrier so powerful there?

I will tell you now, Senator, AT&T is the one with the market power in that situation, and that is what is going to happen. Because of the FCC rules and the inhibitions and the restrictions being placed on the LECs in their own territory and the fact that this is a brand-name game, that is what is going to happen.

Senator LEAHY. Thank you.

Senator THURMOND. Mr. Salsbury or Mr. Atkinson, what is your response to the argument that there was no particular reason for initially dividing the Bell System into seven Bell operating companies instead of five, so there should be no objection now to the proposed consolidations?

Mr. SALSBURY. I will take that first, Senator. I am sure glad they did divide it into seven rather than one. I think really the merger analysis that would be applied now is a market power analysis. Is there a substantial reason to believe—is it substantially likely that allowing these companies to merge would decrease competition in

the local markets or the long distance markets? As I said, Senator, there is a substantial reason to believe that.

First, with respect to local markets, these are the most likely competitors against each other. They know the answers. They know how the network is put together. They know what to ask for. I certainly think we are feeling our way and doing the best that we can as quickly as we can, but we don't know everything about the local business. They know it. The same way with them coming into the local distance business; we know much more about it than they do.

I would minimize somewhat the brand argument that Mr. Barr pointed out because the AT&T was not a legacy of the monopoly. That was all after the divestiture. They invested in that, they created that over the last 12 years. The brand before divestiture was the Bell System.

I really do believe that as we go forward, we will see competition develop slowly, but these mergers, if they are allowed to go forward, will impede it. The question should really be asked, is it any more likely that competition will be developed in these markets with these mergers. As I said, for reasons I said before, these are the best, most likely competitors, so I think the answer has to be no.

Senator THURMOND. Senator Leahy, do you have any more questions for the second panel?

Senator LEAHY. I do, but I will submit them for the record. I know we have a time problem, Mr. Chairman.

[The questions of Senator Leahy are located in the appendix.]

Senator THURMOND. We will now move on to the third panel. Thank you, gentlemen, for your presence.

We welcome Mr. Peter Huber, Mr. Robert Crandall, Mr. Robert J. Binz, and Mr. Dale Hatfield. You can now make opening statements of 5 minutes each, starting with Mr. Huber.

**PANEL CONSISTING OF PETER W. HUBER, SENIOR FELLOW, MANHATTAN INSTITUTE FOR POLICY RESEARCH, NEW YORK, NY; ROBERT W. CRANDALL, SENIOR FELLOW, BROOKINGS INSTITUTION, WASHINGTON, DC; RONALD BINZ, PRESIDENT, COMPETITION POLICY INSTITUTE, DENVER, CO; AND DALE N. HATFIELD, CHIEF EXECUTIVE OFFICER, HATFIELD ASSOCIATES, INC., BOULDER, CO**

**STATEMENT OF PETER W. HUBER**

Mr. HUBER. Well, it is an honor to be sitting in the chair just vacated by a representative from MCI. Almost 10 years ago today, an issue arose under the divestiture decree, which was whether legally a Bell company had a right to go into another Bell company's territory to provide local exchange service. It wasn't clear whether that was permitted under the divestiture decree or not. MCI adamantly opposed it. They said it wasn't allowed under the divestiture decree; the Bell companies should be strictly barred from entering each other's markets under the divestiture decree.

As recently as a year ago—I have been participating in these hearings for almost as Long as I can remember and I do notice that all this sudden realization that Bell companies are natural com-

petitors to each other arrived only after the mergers were announced. Nobody was listing them—and I have gone and looked with some care—virtually nobody was listing the Bell companies as the principal potential competitors against each other until these mergers began being discussed. It just wasn't on the record.

You may find one or two stray comments, but I can absolutely guarantee you, if you look at what the FCC was saying, the Department of Justice was saying, Senators in this very room were saying at the time in one hearing after the next, there was lots of talk about who would enter local phone companies and compete and it was almost never even mentioned of one Bell company entering against another. There were cable companies mentioned, wireless companies, long distance companies, CAP's, MFS, TCG, you name it; no Bell companies. They were virtually never mentioned.

We are fortunate that we don't have to invent our antitrust law from scratch. We do have 100 years of history and we have some pretty good and well-tested criteria for what kinds of mergers are procompetitive and what kinds of mergers are anticompetitive.

To begin with, antitrust law does not focus on size or access or diversity or other popular words of this kind. Antitrust law focuses on market power and what will increase market power or change market power. Assessed according to that criterion, the real, well-tested criterion, the headline-making aspect of all these mergers is that there is no headline. They are just pretty boring, unimportant events, assessed according to traditional antitrust criteria.

If, perchance, we ever get these mergers tested in court, I expect that is what a judge will ultimately say. Of course, they may not be tested in court, but I think if it gets tested in a neutral tribunal, that will be confirmed. I mean, market power must be assessed in terms of properly defined geographic markets and product markets, and this fact is often overlooked. But the local phone markets are truly local. A phone in New York does not substitute for a phone in Washington, DC, not a local phone. The long distance markets are truly national markets. AT&T and MCI have been saying that for 12 years and they were right about it. They are not New York-Washington, DC, markets, or Dallas to San Francisco markets.

Second, competition has got to be assessed in terms of a properly defined product, and all of the trends in the market, certainly not completed yet, but all of the trends are toward a convergence of products, cable companies beginning to provide voice over their networks, phone companies beginning to provide video, all of them getting into data; in fact, voice, video and data all converging into a single large digital market.

In that kind of product market, with those trends in force, the aspects for more competition, the promise of more competition is very great and these mergers do not implicate that. These mergers would implicate that potential for competition if we had Bell Atlantic merging with TCI in the Washington, DC, service market, or if we had SBC and Bell Atlantic merging their cellular operations in Washington, DC. Those would raise serious antitrust concerns, but merging a local market in New York with one in Washington, DC, does not.

The second point is a term like "access" does not define market power. These merged phone companies will have access to quite a

few homes. DBS satellites have access to about 100 million homes in this country. AT&T and MCI in various ways have access to essentially every home in the country, but none of those measure actual market power. We have to look at the real things that do. What determines market power is differentiation of service, but all the trends in these markets are toward convergence of services and rising shares of discreet geographic markets, which these mergers do not implicate.

Thank you very much.

[The prepared statement of Mr. Huber follows:]

PREPARED STATEMENT OF PETER W. HUBER

MARKET PRESENCE VERSUS MARKET POWER

To the untrained eye, the already huge seem to be getting huger too fast for comfort. Big is said to be inefficient. Or the mega-corporation threatens to become too effective and influential for democracy to resist.[1] Sometimes the concerns are baldly populist: Big is just plain bad.[2] Too-large telecommunicators will end up suppressing telecommunication—free speech—itself.[3] Ironically, regulators often help create the leviathan that other regulators then condemn—by granting exclusive franchises because economies of scope, network externalities, club theory, and so on, are said (by the first gang of regulators) to make a single provider more efficient or egalitarian than competition.[4]

The second gang, however, does not see efficiency: it sees Orwell's dystopian vision, Big Brother Inc., a vast and rapacious network octopus, cornering all communication and, in the end, controlling everything. Money and commerce are overwhelming the marketplace of ideas.[5] Excessive concentrations of capital in media businesses are crushing diversity and suppressing expression nationally and even globally.[6] They are bringing about a "mutilation of the community's thinking process."[7] Time Warner, Gannett, NBC, and "media predators like Rupert Murdoch, Robert Maxwell, and Silvio Berlusconi * * * challenge the traditional view, explicitly expressed in the Bill of Rights, that only the state imperils free speech."[8]

Vivid rhetoric often substitutes for careful analysis. Basic economic principles are often muddled—"access" to potential customers, for example, is not market share. Video programming is distributed to U.S. households over many different media.[9] Over-the-air broadcast reaches 98 percent of households. More than 80 percent of American households have VCRs. Cable passes 97 percent. Another 4 percent are equipped with home satellite dishes.[10] When fully deployed, DBS and telephone-company video services will both reach almost 100 percent.[11] Thus, many firms can have ubiquitous "access," just as both Exxon and Mobil can sell gas to everyone. Market share is not measured by who can drive up to your pump, or how much octane resides below—it is measured by how much is pumped and paid for. A cable network like CNN has "access" to virtually every television household in America, yet enjoys a market share (based on viewing time) of only 1 percent. The more "access" a firm has, the more it can compete against everyone else.

Nor is "bigness" in itself an antitrust offense. "Deep pockets" or vast financial resources may facilitate anticompetitive conduct,[12] but they do not make it inevitable. Concerns about corporate gigantism may have motivated Senator Sherman himself,[13] but the Supreme Court noted that the Sherman Act "offers no objection to the size of a corporation, nor to the continued exertion of its lawful power, when that size and power have been obtained by lawful means * * *."[14] Size does not determine guilt.[15]

VOICE, VIDEO, AND DATA

The new, competitive technologies of the broadband telecosm are too fluid and powerful to be locked into the old, simple, regulatory categories of common carriage and broadcast.

This is the most important lesson we have learned from cable. Cable is too capacious. It does not fit any neat, bureaucratically convenient pigeon holes. It retransmits over-the-air broadcasts, and when it does, it is essentially a carrier. It provides leased lines or "public access" channels, and those are even more carrier-like. It transmits cablecasting—that's publishing. It provides two-way phone service—that's carriage again.

It is no longer useful to think of broadband pipes as ordinary wires. They are bundles of virtual channels, carrying clusters of constantly evolving services. Cable

channels operated for pure carriage, without discrimination, are one legitimate business. Cable channels operated for pure cablecasting are another. Cable channels operated for phone service, yet another. And the way a channel is peddled and used can of course change with time.

All the other broadband technologies now unfolding are chameleons, too. Both radio and television broadcasters also use parts of their spectrum to provide carriage. Many paging services piggyback their signals on FM subcarrier frequencies; when the resident from Seattle travels to Miami, her office tracks down the beeper in her pocket with the assistance of FM radio stations around the country. Paging—a locator service—is bought and sold as common carriage, but it depends on broadcasting to locate travelers.

Satellite technology straddles the old regulatory divisions as well. Satellite operators are mostly carriers, except for the four million homeowners who own a large enough antenna—for them, satellites are direct broadcasters. Higher-powered satellites can reach much smaller antennas. By scrambling signals, and then selling decoders, broadcasters redefine themselves as for-pay narrow-casters. Cellular telephony or television can privatize broadcast spectrum even more.

Landline phone companies move in the opposite direction. Video dialtone services do for video what 976 services did for voice: they effectively transform the telephone network into a "broadcast" medium, capable of delivering the Super Bowl to millions of households. A dial-a-porn service is far more like a topless radio station than like a Sunday afternoon phone call to Aunt Gwendolyn in Missoula. Broadcasters, in short, are mastering the art of keeping the broad while narrowing the cast. Telephone companies are keeping their switched, addressable capabilities while widening their bandwidth and their reach. Nobody casts drift nets any more. They are all fly fishermen now.

With the advent of digital technology, the old divisions between voice, video and data services disappear once and for all. A full-bore digital, broadband network will empower everyone to cast broadly or narrowly at will. The on-line world already does so: anyone can create a bulletin board, and anyone can post musings on it, whether wise, foolish, tasteful, crass, or crude, to be read by the world. With digital broadband technology, the text-based bulletin boards will support voice and video. Broadband carriers will have room to carry anything anywhere; on their networks, anyone who chooses will be an instant broadcaster. Tomorrow's broadcasters will have the power to narrow and address their signals at will; on their networks, anyone who chooses will be an instant carrier.

A few diehard providers may decide to keep their businesses strictly on one side of the old definitional line or the other, or be forced to do so by reactionary regulators. For the most part, however, the clear, familiar legal divisions between carriers and broadcasters will be impossible to maintain. In the broadband telecosm, "carriers" and "casters" will compete head-to-head in a single unbounded arena.

## BIG FISH, BIGGER POND

Because digital services are converging so fast, companies can grow and merge while still losing market share. Television used to travel by air, telephone by wire. Today, cable is the dominant medium for transporting television signals over the last mile to the home. Meanwhile, the fastest growth in telephony is wireless, and cable companies have been among the most aggressive and ambitious developers of these wireless services. Telephone companies have at hand the technology to carry video over their existing networks, and they are now being granted the legal authority to do so.

The effects of this convergence are already evident in many previously discrete markets. The formerly monolithic Hollywood studios, once the target of major antitrust suits, were largely freed of their consent decree in 1987.[16] The traditional broadcast networks peaked some years ago, and are now steadily losing market share.[17] Cable has replaced broadcast as the dominant video delivery service, but now faces challenges from both telephone company video dialtone and from direct broadcast satellite.[18]

The market power of local telephone companies is declining too, though different observers disagree sharply about how fast. In the United Kingdom, the incumbent local carrier is losing an estimated 15,000 subscribers a month to cable services, provided in large part by U.S. cable television companies working in collaboration with U.S. local telephone companies.[19] In the 1990s, wireless technology will compete directly with landline services. The FCC projects 60 million users of new generation wireless services within ten years.[20] Meanwhile, IBM is self-divesting. Even its advertising now emphasizes the openness of IBM architectures and the compatibility of its wares, both hard and soft, with those provided by other suppliers.[21]

The rising tide of competition in equipment markets is doubly important, because the substitutability of equipment and service is also increasing. This expands markets yet again. There is, for example, a high substitutability between information processing marketed as a service and information sold as computer software and hardware or other equipment. Electronic publishing faces the most direct competition from over-the-air broadcasting and print. And while cable was becoming a household service, VCRs became a household appliance.

While the technology is converging, the geographic scope of markets is expanding.[22] Telecommunication is, by its nature, a boundary-expanding technology. As the geographical boundaries delineating a market expand, the individual players in it can grow without increasing (or even maintaining) market share. A minnow growing to the size of a whale will still lose "market share" if the pond is transformed, at the same time, into the Pacific Ocean.

That is what is happening in the telecom industry today. The big are indeed getting bigger, but the market in which they swim is growing even faster. Viewed as they must be in the context of the markets for which they contend, the big are shrinking even as they grow. Anti-bigness regulation should be shrinking a pace.

ENDNOTES

[1] John S. Shockley, All the Free Speech That Money Can Buy? The Supreme Court Constricts Campaign Finance Reform, *in* Judging the Constitution 378, 389 (Michael W. McCann and Gerald L. Houseman eds., 1989).

[2] *See, e.g., Standard Oil Co.* v. *United States*, 221 U.S. 1, 83 (1911) (Harlan, J., concurring in part and dissenting in part); *United States* v. *AT&T*, 552 F. Supp. 131, 163–64 (D.D.C. 1982) (antitrust laws thus "embody 'a desire to put an end to great aggregations of capital because of the helplessness of the individual before them.'") (quoting *United States* v. *Aluminum Co. of America*, 1 F.2d 416, 428 (2d Cir. 1945)); 21 Cong. Rec. 2457 (1890) (remarks of Senator Sherman) ("[I]f we will not endure a king as a political power we should not endure a king over the production, transportation, and sale of any of the necessaries of life."). *See generally* Owen M. Fiss, Why the State?, 100 Harv. L. Rev. 781 (1987).

[3] *See, e.g.*, Ben H. Bagdikian, The Media Monopoly 90–101, 216–20 (1990); Laurence Tribe, Toward A Metatheory of Free Speech, *in* Constitutional Government in America 1 (Ronald K. L. Collins ed., 1980); Norman Dorsen, The Need for a New Enlightenment: Lessons in Liberty From the Eighteenth Century, 38 Case W. Res. L. Rev. 479, 492 (1988).

[4] *See* John Thorne, Peter W. Huber and Michael K. Kellogg, Federal Broadband Law § 4.2.3 (Boston: Little, Brown and Company, 1995).

[5] *See, e.g.*, C. Edwin Baker, Private Power, the Press, and the Constitution, 10 Const. Comment. 421, 424–25 (1993); Lee C. Bollinger, Images Of A Free Press (1991).

[6] *See, e.g.*, Herbeft I. Schiller, Response: Television Is a Social—Not a Biological or Technological—Problem, 68 Tex. L. Rev. 1169, 1170 (1990).

[7] Stanley Ingber, The First Amendment in Modern Garb: Retaining System Legitimacy—A Review Essay of Lucas Powe's American Broadcasting and the First Amendment, 56 Geo. Wash. L. Rev. 187, 216 (1987).

[8] Herbert I. Schiller, Response: Television Is a Social—Not a Biological or Technological—Problem, 68 Tex. L. Rev. 1169, 1170 (1990). The anti-business rhetoric is on occasion openly Marxist: "[T]he current scene becomes the most advanced stage in capitalism's long history of advantaging property rights. Beginning with the ownership of land, the advantage has progressed to industrial capital, and now to information." *Id.* at 1173.

[9] For a time, the FCC recognized that the distribution market for video programming should include all sources of video programming. *See* Notice of Inquiry, Compulsory Copyright License for Cable Retransmission, 2 F.C.C. Rec. 2387, 2388 (1987); Jonathan D. Levy and Florence O. Setzer, Office of Plans and Policy, FCC, Measurement of Concentration in Home Video Markets 41–48, 51, 100–101 (1982). Several court judgments have also reflected the determination that the video distribution market should be broadly defined. *See, e.g., Cable Holdings, Inc.* v. *Home Video, Inc.*, 825 F.2d 1559, 1563 (11th Cir. 1987); *Satellite Television & Associated Resources, Inc.* v. *Continental Cablevision, Inc.*, 714 F.2d 351, 355–56 (4th Cir. 1983), *cert. denied*, 465 U.S. 1027 (1984). More recently, however, Congress has required the Commission to take a much narrower view of what constitutes "effective competition" against cable. 47 U.S.C. § 543(l)(1)(B) (1994).

[10] About 1 percent receive programming by way of SMATV, which has approximately 1 million subscribers.

[11] Sports arenas, concert halls, theaters, and 25,000 movie screens provide additional outlets and, in principle, have "access" to every consumer who is willing to get in a car or on a subway.

[12] *See, e.g., United States* v. *Aluminum Co. of America*, 148 F.2d 416, 429–30 (2d Cir. 1945); *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 317 (1962) (Congress sought to erect barriers to "the rising tide of economic concentration."); *United States Steel Corp.* v. *Federal Trade Comm'n*, 426 F.2d 592, 603–4 (6th Cir. 1970) ("[T]he sheer size and financial resources of [the petitioner] visit non-competitive stabilizing forces upon [its] competitors."); *Kennecott Copper Corp.* v. *Federal Trade Comm'n*, 467 F.2d 67, 78 (10th Cir. 1972) ("[Petitioner] takes strong exception to the Commission's consideration of the anticompetitive effect of its great financial resources.").

[13] *See United States* v. *Aluminum Co. of America*, 148 F.2d 416, 428 (2d Cir. 1945) ("In the debates in Congress Senator Sherman himself * * * showed that among the purposes of Congress in 1890 was a desire to put an end to great aggregations of capital because of the helpless-

ness of the individual before then "). *See also* 21 Cong. Rec. at 2460 (remarks of Senator Sherman).

[14] *United States* v. *United States Steel Corp.*, 251 U.S. 417, 460 (1920).

[15] According to Professors Areeda and Turner, such arguments are "outside the conceptual framework of economic 'science,'" "conceptually indefinite," and "intrinsically unmeasurable." *Phillip Areeda and Donald F. Turner* v. *Antitrust Law* ¶ 1142d (1980).

[16] *See* John Thorne, Peter W. Huber and Michael K. Kellogg, Federal Broadband Law § 8.3.2 (Boston: Little, Brown and Company, 1995).

[17] For example, the networks' aggregate share of the nationwide prime-time viewing audience had declined from roughly 90 percent in 1970 to around 66 percent today, and their aggregate share of television advertising revenues declined from 48 percent in 1970 to around 33 percent today. *See* Report and Order, Evaluation of the Syndication and Financial Interest Rules, 6 F.C.C. Rec. 3094, 3108–09 (1991); Second Annual Report, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 11 F.C.C. Rcd 2060, 2114 (1995); Mark Evans, Web Sites Have Content, Need Investors: Market Appeal of Content-Rich Internet Sites Suffers From High Valuations, Sluggish Advertising, The Financial Post, July 25, 1996, at sec. 2, p. 25. Advertising revenues for the four main networks are extrapolated from figures for the first half of 1995.

[18] *See* Second Report and Order, Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54–63.58, 7 F.C.C. Rcd 5781, 5797–98 (1992). *See also*, Speech of Vice President Albert Gore, Royce Hall, UCLA, Los Angeles, California, Jan. 11, 1994; The Chicken, Maybe; A Chicken in Every Pot and Two Wires Into the Home: the Prospects for Cable Services Offered by Phone Companies, Broadcasting & Cable, Nov. 15, 1993, at 98.

[19] Dixon, Goodwin & Co., Technology Assessment—UK CATV/Telephony 2 (Aug. 1993). Interestingly, the telephone portion of the cable-telco combination drove penetration growth for the video side. In the first year cable companies offered telephone service, they saw their cable subscribership increase by almost 70 percent. By July 1993, less than three years after offering cable telephony, the number of subscribers to cable television had almost tripled to nearly 475,000. *Id.*

[20] Notice of Proposed Rulemaking and Tentative Decision, Amendment of the Commission's Rules to Establish New Personal Communications Services, 7 F.C.C. Rec. 5676, 5688 (1992).

[21] IBM's advertising now declares: "The idea of open systems—that computers should easily share things and basically behave like friends—is what everyone is aiming for." IBM Advertisement, Forbes, Nov. 23, 1992, at 202.

[22] William Landes and Richard Posner maintain that a firm's market power is radically refigured downwards with the expansion of geographic market boundaries. As a firm presses the extension of its sales outward, exporting its good or service to non-local regions, production in the distant market will likewise constrain the exporting firm's market power, even in its *home market*. William M. Landes and Ricahrd A. Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937, 968 (1981).

Senator THURMOND. Mr. Crandall.

## STATEMENT OF ROBERT W. CRANDALL

Mr. CRANDALL. Thank you, Mr. Chairman. It is a pleasure to be here, Mr. Chairman and Senator Leahy. I have a prepared statement that I will ask to be submitted for the record and I will just summarize very briefly.

I have been a student of this industry for more than 20 years and have probably published about 4 books in the last 8 or 9 years at the Brookings Institution on the communications sector of the economy. I must tell you, in anticipating some of your questions and sitting and listening to others address the previous panelists, that when you ask for predictions about how this industry is going to shake out now that the 1996 Telecommunications Act is in place, I think the honest answer is that we don't know.

What has happened here is that you have fundamentally shaken up an old-line, regulated industry which was in the throes, anyway, of major changes caused by rapidly advancing technology. Even the experience that we have had from previously deregulated industries, I don't think, begins to suggest how dramatic the changes will be.

The changes will be toward much greater competition because the most important thing you have done is to eliminate a primary barrier to competition, which was the State regulatory commission's ability to restrict entry into local and interLATA markets. For that, I think you are to be applauded.

In addition, in the last year, the Federal Communications Commission has decreed that AT&T is no longer a dominant carrier. Whether you believe some of the assertions about how regulation combined with other forces in the market to create an implicit cartel of long distances or not, there is no doubt that allowing firms to respond more quickly to competitive thrusts, as AT&T now may through its nondominant status, means that I think this sector of the economy, this part of the industry, will become much more competitive.

Prices have not yet reached their competitive equilibrium in that sector, and a good example of that is in the following numbers. Today, the average price above access charges for interLATA services in the United States is probably somewhere around 11 cents. The long distance companies are today offering their services at wholesale to resellers at, for very large deals, somewhere between 1 and 2 cents, which may approximate what their long-run costs are of providing that service.

The idea that the rest of that margin, 9 to 10 cents, must be absorbed by selling costs and administrative costs, I think, is one which probably will not be sustained by the marketplace. The reason why we heard so many people change suppliers each year is a function of how high the incremental cost margin really is today. So I think that sector of the economy will become much more competitive as well.

As Mr. Huber suggested, the mergers which you are considering today do not involve mergers of currently competing companies. To the extent that they are competing today, it is only in a minor sort of way. Their basic local and interLATA services are not in competition with one another. Also, the question that you asked earlier about whether the market would have shaken out as five or seven large local companies in the absence of the MFJ in 1984, I think, is a very good one. We simply don't know.

But what we do know is that the companies that are combining today are not in fundamental competition with one another. As Mr. Huber pointed out, in an antitrust case under the Clayton Act, if they are not in competition with one another and you have to fall back on a potential competition argument, then, as Attorney General Barr pointed out, you have to point out that they are uniquely positioned to enter this market and no one else would enter, or very few others would enter. I don't think that case can be made at all.

Finally, let me point out that in every other industry that we have deregulated, there has been a rush of entry, a rush of exit, combinations, mergers that succeeded and mergers that failed abysmally. In no case would we have predicted that things would work as well as they did; that is, costs fell dramatically as a result of all sorts of changes in these industries; the entry of UPS, for instance, or Fed Ex into the small-parcel service that the less-than-truckload carriers were involved in. The fact that Southwest Airlines became the most efficient carrier in the airlines industry would not have been predicted ab initio.

I would conclude by saying that I see no threat from these mergers, but also I don't think anybody testifying before you can tell you how this industry is going to shake out. The fundamental fact is

competition has been enhanced by the lowering and the reduction, if not the total elimination, of regulatory entry barriers, and I think what we are going to see is a very competitive telecommunications sector down the road. But who the players will be, what their market shares will be, how many local carriers we have, how many long distance carriers we have are something that I think nobody can predict at this point.

[The prepared statement of Mr. Crandall follows:]

PREPARED STATEMENT OF ROBERT W. CRANDALL [1]

Mr. Chairman and members of the Committee, it is a pleasure to appear before you today to express my views on the recent merger activity in the telephone industry. My views are based on thirty years of studying market structure and competition in such diverse industries as steel, motor vehicles, communications equipment, rubber tire, broadcasting, cable television, and telecommunications services. In the past few years, I have been the author or co-author of two Brookings books on telecommunications policy, *After the Breakup: U.S. Telecommunications in a More Competitive Era* (1991); *Talk is Cheap; The Promise of Regulatory Reform in North American Telecommunications* (1996, with Leonard Waverman); and *Cable TV: Regulation or Competition?* (1996, with Harold Furchtgott-Roth) as well as of numerous articles dealing with telecommunications issues. I have also served as a consultant to numerous telecommunications companies, including the members of the U.S. Telecommunications Association in the FCC's recent interconnection proceedings.

The recent mergers in the telephone industry are but one manifestation of a tremendous upheaval in the industry. Rapid technological change and dramatic changes in government regulatory policies have been unsettling to the established order. One can no longer confidently discuss the future of local telephone companies, cable television firms, or long-distance companies without realizing that each is poised to enter the other's business and that numerous other entrants lurk on the periphery with new wireless or satellite technologies, Change is coming in ways that few of us, including the executives of large telephone companies, can predict.

The inevitable impact of these changes is a divergence in the views of market participants as to the winning technologies or strategies. Some may view the large wireline investment of local telephone companies as the source of a "first-mover" advantage while others may see this inherited plant as a lodestone around the necks of the local companies. Those with the more bullish views will be buyers of LEC assets—as portfolio investors or acquirers—while others may be sellers.

This year, two large mergers between Regional Bell Operating Companies have been announced. SBC Communications has announced its intention to acquire Pacific Telesis, and Bell Atlantic has announced its intention to merge with NYNEX. Both mergers involve the combination of two, largely non-competing, local telephone companies that have a variety of other businesses, including domestic wireless operations, a number of wireless and wire-based video operations, and international investments.

THE STRUCTURE OF U.S. TELECOMMUNICATIONS MARKETS

The 1996 Telecommunications Act will have a dramatic effect on the structure of U.S. telecommunications markets. Until this year, the Regional Bell Operating Companies (RBOCs) have been barred from interLATA service markets by the AT&T decree, and most states have barred entry into their local telephone markets. The 1996 Act will change all of this, entry into the local and interLATA markets will now be open, although the RBOCs' interLATA entry requires the scaling of a few regulatory hurdles.

The interLATA markets have become increasingly competitive, but it is likely that prices in these markets have not yet reached a competitive equilibrium. AT&T's share has fallen to less than 55 percent of the revenues of all long-distance carriers, while the shares of MCI, Sprint, and LDDS Worldcom now total about 33 percent. However, AT&T had more than 70 percent of presubscribed lines as of December 1994. Equally important, these large carriers are now poised to enter the local and intraLATA long-distance markets, using a variety of technologies and market strategies.

[1] The views expressed herein are solely my own. They should not be taken to represent the views of the Brookings Institution, its other staff members, or its Trustees.

The local exchange markets are now open to competitive entry through the construction of new facilities, the leasing of the incumbent local carriers' unbundled facilities, or resale. The number of potential entrants using any of variety of such approaches is very large. Obviously, each of the four large long-distance companies is now pursuing its own strategy for entering local markets. Each of the large cable companies, such as TCI, Time Warner, Jones Intercable, Cablevision, or Cox loom as major threats to incumbent telephone companies because of the existing cable plant whose backbone is being converted rapidly to fiber optics. A large number of smaller companies are either negotiating interconnection agreements or have signed such agreements with the major local-exchange companies already. Three new wireless competitors are poised to enter each local market, having paid between $4 billion and $10 billion nationwide in recent FCC spectrum auctions. Motorola is building a network of low-orbiting satellites that will be capable of offering connections to U.S. businesses or households in the near future. Each existing local telephone service provider—whether an RBOC or an independent company—is a potential entrant into all of the others' markets. In addition to the seven RBOCs, there are at least five other local telephone companies—Alltel, Cincinnati Bell, Frontier, GTE, and Southern New England Telephone—that could pursue such expansion. Finally, there are a variety of other large companies, some with telecommunications investment and some without, as well as numerous foreign carriers that could enter the market for local communications in the United States.

In short, with entry barriers lowered or removed by the 1996 Act, there is now the potential for substantial entry into all aspects of U.S. telecommunications. Given the rate of technical change and the possibility of exploiting joint economies in delivering of marketing a variety of communications services to the household—local telephony, long-distance service, Internet connections, and video—we are about to witness the collision of very large players in the marketplace.

The two major RBOC mergers announced recently do not involve companies that are direct competitors in local or intrastate toll markets. Rather, the two mergers involve companies that are in adjacent territories or even farther away. Even if these companies were potential entrants into each others' markets in the absence of the mergers, with so many potential entrants it is difficult to see how a few mergers among largely non-competing local-exchange companies could affect the vitality of this competition.

## POTENTIAL BENEFITS OF TELECOM MERGERS

When any industry is subject to the external shocks of technical change and deregulation, existing firms will find it necessary to adjust rapidly to meet the developing competition. The result will be a variety of new investment plans, asset write-downs, and acquisitions. Some of these decisions will prove successful; others will not. But no one can predict at this juncture what the winning strategy will be in such a dynamic industry as telecommunications.

Indeed, no one could have predicted how even less technologically-dynamic industries, such as airlines and trucking would adjust to deregulation. In both industries, there were large numbers of new entrants, large mergers, and a substantial number of bankruptcies. For instance, PanAm and National Airlines merged and ended in bankruptcy; Northwest and Republic merged and have survived by combining their networks. Southwest has expanded successfully without acquisitions. In the LTL trucking sector, the large carriers have pursued an aggressive acquisition strategy, greatly reducing their operating costs, and rates as a result. Many other LTL carriers have been forced to exit in the face of the sharply declining rates.

In telecommunications, the pace of technical change is much more rapid than it has been in the transportation sector. Faced with the prospects of new entry into their core markets, the major companies must devise new strategies. MCI, AT&T and Sprint are each beginning an assault on local markets with different strategies. The local operating companies will have to respond by improving their efficiency, building new facilities, and expanding their services. There is no reason to believe that the current geographical boundaries of these companies' local service areas create the most efficient agglomerations to offer telephone and video services. Nor is it likely that these companies are emerging from decades of state regulation with the most efficient structures or operations.

One way for the local carriers to improve their efficiencies and develop a variety of services through which they can exploit joint marketing economies is through acquisitions. For example, the Bell Atlantic-NYNEX merger could conceivably lead to much more efficient operations in the New York metropolitan area or allow greater efficiencies in marketing local telephony, long-distance service, and video services

along the east coast. These efficiencies, like the efficiencies obtained in the LTL trucking mergers, would be reflected in lower rates for consumers.

Mergers also provide an opportunity for new management and a new approach to organizing and operating firms in a changing environment. Both the SBC-Pacific Telesis and Bell Atlantic-NYNEX mergers may provide such opportunities.

CONCLUDING COMMENTS

There is nothing about the recently-announced telecom mergers that need concern the Congress or the antitrust enforcement agencies. Because the largest of these mergers involve combinations of essentially non-competing firms, it is unlikely in my view that the antitrust authorities will be able to or should be able to block them in the courts. No one can know how the telecommunications sector will develop in the next few years with deregulation and the liberalization of entry. But with so many large players attacking one another's turf, it is difficult to see how competition is threatened by these mergers. Congress has opened the door wide to competition with the passage of the 1996 Act. A few large mergers will not even begin to close it and may open it even wider.

Senator THURMOND. There is a vote in the Senate. We will have to take a recess for about 10 minutes and we will be back at that time.

Senator LEAHY. Mr. Chairman?

Senator THURMOND. Senator Leahy.

Senator LEAHY. Mr. Chairman, I am not sure whether I will be able to get back, but if I don't——

Senator THURMOND. Would you like to go ahead now?

Senator LEAHY. I wonder if I might just ask one question now, but then submit the rest for the record.

Senator THURMOND. Senator Leahy will ask questions. I will go and vote and come back.

Senator LEAHY. I was just thinking that Mr. Ebbers said in the earlier panel that neither WorldCom nor MFS is the incumbent monopoly or former monopoly. Both have market share in the single digits. He said a merger between the two companies would be a big yawn in terms of antitrust issues. Do you agree with that?

Mr. CRANDALL. Are you asking——

Senator LEAHY. Any one of you. Mr. Crandall?

Mr. CRANDALL. I think Mr. Huber said it would be a big yawn in terms of antitrust issues. I don't think having been a former monopolist is a criterion for being a fighting tiger. The fact that these two firms are former monopolists probably means that they have been spared the necessity of having to respond to competition and be as fighting mean and lean as they otherwise would be. I think I would rather go up against former monopolists.

Senator LEAHY. You are not saying that WorldCom or MFS are former monopolists, are you?

Mr. CRANDALL. No. I am saying that the mere fact that the regional Bell operating companies or their antecedent company, AT&T, were monopolists at some point in history because of regulatory protection does not make them such formidable opponents; quite the contrary.

Senator LEAHY. In trying to make it easier for the home viewers, we have now the Senator who actually is a man with a full head of hair, but he apes my hairline, Senator Simpson, who has come here to fill in to keep the continuity going, and we will correct the record on that part afterwards. [Laughter.]

Senator SIMPSON [presiding]. I think we should correct it right now.

Patrick, I have not voted because I have been rambling around. I believe that the testimony hasn't even been completed here. It is one of those days as we drawn down to the end, but I have a statement and it will be inserted into the record as if read in full.

[The prepared statement of Senator Simpson follows:]

PREPARED STATEMENT OF SENATOR ALAN K. SIMPSON, A U.S. SENATOR FROM THE STATE OF WYOMING

First, I want to address my good friends Senator Hatch and Senator Thurmond and commend both of you for scheduling the hearing to examine the issue of competition in the telecommunication industry. Although this is a full committee hearing, its subject matter is clearly antitrust and I wanted to come by today—in what is likely to be my last antitrust hearing in the Senate—to say a few words of tribute to the man who urged me to serve on this committee nearly 18 years ago. He is my loyal friend, mentor, and always the "Chairman," Senator Strom Thurmond. Strom, you have been an inspiration to me and to so many other colleagues because of your integrity, your commitment to principles, your unparalleled political acumen, your physical vitality, and for your great devotion to public service. You will have seen two Simpsons come and go through here and for the benefit of others who will follow me, I hope that you will remain here to provide them with the kind of leadership and friendship that you always showed my father and have always shown me.

I think we would all agree that one of the most historic achievements of the 104th Congress was enactment of the Telecommunications Act of 1996. Our goals were to increase competition, to create new job opportunities, and to provide better products and services for the consumer at better prices.

In simple terms, we seek to change the face of the local exchange marketplace and increase competition in the long distance field. These are ambitious goals that have been many years in the making and I strongly believe we need to do all we can now to ensure that the Telecommunications Act, as implemented, has the best chance to achieve these goals.

The announcements of proposed mergers between certain Bell companies come at a time when we are still at the earliest stages of determining how best to implement this act, and how we can achieve the greatest benefits from enhanced competition.

I am not here to advocate that our committee should micromanage the proposed mergers. I do believe, however, that at this critical time of policy implementation, we have a duty in our oversight capacity on "antitrust, business rights, and competition," to examine whether industry consolidation will promote or hinder the primary goal of the act—that is, to foster real competition in the telecommunications industry.

There has been such a remarkable growth in the long distance market over the past 10 years that today—although three companies still dominate the market—hundreds of new companies are entering and competing for customers. Long distance rates have fallen and consumers are being offered better products and more responsive service. Today, Wyoming consumers have a choice between 15 long distance carriers—something that was unheard of 10 years ago. The new telecommunications law should enable them to eventually benefit from similar competition in the local service market.

The Telecommunications Act will provide opportunities for small companies to compete for both long distance and local service markets in States like Wyoming. I voted in favor of this legislation precisely because I felt it would promote competitive pricing and enthusiastic and competent service, not only for my constituents, but for every "Joe six-pack" American, who today is forced to buy local service from a monopolistic provider.

I have not had an opportunity to review either of the merger proposals that are under such intense consideration by the industry and by State public service commissions, so I do not want to explore or comment on their merits here. Instead, I will simply impart to you my firm belief in the goals of the Telecommunications Act and my sincere interest in seeing them become a reality. We must follow through on our commitment to allow market entry and real competition so small businesses can offer services people not only want, but that they choose. In order to create jobs, improve systems, increase competitiveness, and lower prices, we must keep a vigilant watch to ensure that we are moving steadily away from monopolistic conditions—never toward them.

I thank Senator Hatch and Senator Thurmond for the opportunity to make these remarks. And I thank all of the witnesses who took time to be here to present their

testimonies today. Unfortunately, I have a scheduling conflict and must excuse myself, but I will be carefully reviewing the record.

Senator SIMPSON. I said to all the industry, I remember, when all of this started—all the industries; I remember all of them—I said something to the effect I hope that you can eventually work this out among yourselves because if you drag it in here, we will do it, but it won't be done right. And they all laughed, you know; well, we need to have it come to Congress.

It is my experience in 18 years here that you would have done a lot better if you had all just gotten together because we will do it and we will keep doing it and the theme will be, you know, to bust up monopolistic practices and let everybody in, take everybody and put them in a black burlap sack and shake them up and let them claw each other's eyeballs out. The fire alarm people will be doing cable television and the cable television people will be doing, I don't know, left-handed elbow fiber optic cubes, and that is what is going to happen simply because we don't have time to understand the tremendous complexity and intricacies of the businesses. And nobody feels sorry for anybody because everybody is making a wad. At least that is the way the American public looks at it.

What are we doing with these huge entities, all of them remarkable American corporations, all of them the epitome of capitalism? What are we doing? So I won't be here next year, but I can assure you that as I see the theme of it, it will be to just continue to try to see that everything is opened up in a way that is best for one single person, and that is the consumer.

I know you all say continually that that is the great desire, but sometimes it is not. It comes down to things like greed and squeezing out somebody else, and if you are bigger, we are going to try to prevail to get bigger yet. Anyway, competition is the theme and I hope we can do it in a way—I haven't reviewed either of the merger proposals that are under intense consideration and I don't want to comment or explore the merits here, but simply say my firm belief is in the goals of the act that we tried so hard to do correctly, that it becomes reality, that we follow through on the commitment to allow market entry at all levels, real competition at all levels, so the little guys in the small business can offer services, and people want those services, but that they are able to choose those services in order to create jobs and improve systems and increase competitiveness and lower prices, and keep a vigilant watch to ensure we are moving steadily away from monopolistic conditions and never toward them.

So, with that theme, as I say, I remember when it all started, and Lord knows you have been through an anguishing time. I hope we can do it right, but don't expect that it will ever really be done right here in the legislative arena because of the obvious complexities and the need for regulatory reform and control, and so on. Now, with that ringing little tidbit, I must press on to go vote. I was stalling, and no one is here. [Laughter.]

Senator Thurmond said he would be back, so we are going to have to recess for a few minutes, if you will please do that, and thank you for the opportunity of making some remarks. I am sorry about the situation. We will recess until the return of the Chair.

[Recess.]

Senator THURMOND. The committee will come to order.

Mr. Binz, I don't believe you have made an opening statement yet, have you? So you go right ahead for 5 minutes.

## STATEMENT OF RONALD BINZ

Mr. BINZ. Thank you, sir. Mr. Chairman, my name is Ronald Binz and I am president of the Competition Policy Institute. CPI is a nonprofit organization which advocates State and Federal policies to bring competition to energy and telecommunications markets in ways that will benefit consumers. CPI was established in March of this year and received its initial funding from a group of new entrants into the telecommunications markets. We develop our policy positions independent of the funding sources and in consultation with an advisory board of consumer advocates from around the country.

We applaud the committee for holding this hearing to consider the effect which mergers in the telecommunications industry will have on competition and consumers. We are deeply concerned about the rapid consolidation of major players in the telecommunications marketplace and very much appreciate the opportunity to appear before the committee today.

The Telecommunications Act of 1996 was a landmark act and it was passed by the Senate and House in overwhelming majorities this year because it contained a balance between deregulation and competition. Loser ownership restrictions were accompanied by strong measures to enable and encourage the growth of competition in all telecommunications markets. Unfortunately, the mergers of several key industry players may upset this balance and harm both the interests of competition and consumers.

Mr. Chairman, I would like to make three points in this testimony. First, the FCC and the States are working hard to adopt rules necessary to implement the Telecommunications Act of 1996, but progress toward local exchange competition has just begun. Local exchange competition is pretty much still just a theory and it is far too early to conclude whether it will develop in all markets.

As you know, the FCC order just issued which implements the local competition sections of the act was just recently issued by the FCC. Negotiations among carriers have begun, but most negotiations have ended in stalemates and are being referred to State commissions for arbitration. Thus, while competition is permitted in theory, I do not know of a single residential customer in the country that has a choice for local service providers. Most small-business customers do not have a choice for local telephone service. I think we have been lulled into the impression here by these first few panels that local competition is rampant. It is not yet.

It is also troubling that, one by one, the large incumbent local exchange companies have announced their intention to appeal the FCC's new rules. Unfortunately, any momentum gained by the prompt action of the FCC in response to the aggressive deadlines set by Congress will be lost if the companies succeed in obtaining a stay of that decision in court.

My second point is the procompetitive effects of the act may be jeopardized by the consolidation of large telecommunications carriers. Simply put, mergers remove potential competitors from mar-

kets which have just been opened to competition. Some pending mergers create stronger monopolies, having greater resources with which to thwart potential competitors.

Since the passage of the 1996 act, the concentration of ownership in the industry is proceeding much faster than the growth of competition. If consolidation continues to outstrip the growth of competition, the goals that Congress endorsed in the 1996 act may not be achieved. Consumers may end up with higher rates and fewer competitive choices.

My third and final point is the announced mergers of the regional Bell operating companies are especially menacing to the future of local exchange competition. We recommend two measures designed to mitigate the harm to consumers and to competition. First, these mergers should be considered only after the FCC has certified that the companies have met the competitive checklist in the Telecommunications Act for each of the States in which they operate today.

Second, regulators should require that the claimed benefits of the merger flow through to consumers in the form of lower rates. If compliance with the checklist is a precondition to considering these mergers, it is much more likely that competition will develop in local markets and that the damage to competition from the mergers will be mitigated. Importantly, this can be achieved without imposing additional requirements on the RBOC's beyond those already present in the 1996 act.

While mergers are often justified by claims of cost savings from increased efficiencies, consumers may never see those savings. When considering whether to permit the mergers, regulators should require that the promised benefits result in lower rates to consumers. However, regulators should not trade short-term benefits for the long-term damage to the development of competition which some of these mergers might cause.

The goals of the Telecommunications Act were correct, to promote a more competitive deregulatory marketplace for goods and services. Policymakers should ensure that the RBOC's take effective steps to enable competition for local services in each and every State they serve, and ensure that consumers actually benefit from the cost savings.

Once again, Mr. Chairman, thank you for conducting this hearing on this important matter and for the opportunity to testify.

[The prepared statement of Mr. Binz follows:]

PREPARED STATEMENT OF RONALD BINZ

Mr. Chairman and Members of the Committee, my name is Ronald Binz, and I am President of the Competition Policy Institute. The Competition Policy Institute (CPI) is a non-profit organization which advocates state and federal policies to bring competition to telecommunications and energy markets in ways that benefit consumers. CPI was created in March of this year and has participated in proceedings before the Federal Communications Commission (FCC), the State-Federal Joint Board on Universal Service and state regulators.

CPI applauds the Committee for holding this hearing to consider the effect which mergers in the telecommunications marketplace will have on competition and consumers. We are deeply concerned about the rapid consolidation of major players in the telecommunications marketplace.

The landmark Telecommunications Act of 1996 passed the Senate and the House by overwhelming majorities earlier this year because the Act contained the right balance between deregulation and competition. The substantial loosening of owner-

ship regulations contained in that legislation was accompanied by equally strong measures to allow the growth of competition. Unfortunately, the mergers of several key industry players has tipped the balance against the interests of competition and consumers. Since passage of the 1996 act, the concentration of ownership in the telecommunications industry is proceeding much faster than the growth of competition. If this industry consolidation is allowed to continue unchecked, the pro-competitive goals that Congress endorsed in the 1996 act may not be achieved, and consumers may end up with higher rates and poorer service quality.

In the testimony that follows, I will discuss some current events in telecommunications which lead me to the following conclusions:

The FCC and the states are working hard to adopt the rules necessary to implement the Telecommunications Act of 1996, but progress toward local exchange competition has just begun. It is far too early to conclude whether competition will develop in all telecommunications markets.

The pro-competitive effects of the Telecommunications Act of 1996 may be jeopardized by the consolidation of large telecommunications carriers. Simply put, mergers remove potential competitors from markets which have just been opened to competition and some of them create larger monopolies that have greater resources with which to thwart potential competitors.

Mergers of telecommunications carriers will have potential cost and potential benefits for consumers. Regulators and policy-makers must take affirmative steps to minimize the cost and ensure that consumers benefit. Regulators must be particularly careful of the effect of any merger on competition. Any short-run benefits such as cost efficiencies will be dwarfed by the long-run damage to consumers if the development of competition is stymied by such mergers.

The announced mergers of the Regional Bell Operating Companies (RBOCs), Bell Atlantic-NYNEX and SBC-Pacific Telesis, are especially menacing for the future of local exchange competition. These mergers should be considered only after the companies have met the "competitive checklist" contained in the Telecommunications Act of 1996 for each of the states in which they operate today.

## I. STATUS OF LOCAL COMPETITION

The effect of the legislation on the development of competition for local telephone service is just beginning to be felt. The FCC just last month released its initial set of rules governing how competitors may interconnect with the networks of the incumbent local telephone companies. Not surprisingly, several of the incumbent telephone companies have petitioned to stay and overturn the new rules. GTE, one of the largest telephone companies, has asked to be treated as a rural telephone company so that it can be exempted from the new unbundling rules.

In the meantime, states are considering their own rules to implement the 1996 Act. Most states have waited until the FCC published its rules before moving forward.

Pursuant to Section 251 of the Telecommunications Act of 1996, competitors to the incumbent local telephone companies must first engage in negotiations with the incumbent telephone companies before they can take advantage of the new rules. If the parties to these negotiations do not reach agreement, and, to date, many of them have not, the parties must petition the State regulatory officials to arbitrate any contested issues. Many of these arbitration decisions are expected in October and November. Under the 1996 Act, either party to the negotiations may then challenge these arbitration decisions in federal court.

Competitors to the incumbent telephone companies are growing but are far smaller than the incumbent telephone companies. According to one industry analyst, competitors to the local telephone companies earned about $1.3 billion in revenues in 1995, which is less than 1% of the total market for local telephone service.

Of course, another way to judge the scope of competition for local telephone service is to examine the consumer perspective. Frankly, I do not know of one residential consumer who has a choice among alternative providers of local telephone service today.

## II. CONSOLIDATION IN THE COMMUNICATIONS MARKETPLACE

While competition is developing slowly, virtually every sector of the communications marketplace has seen substantial consolidation. In the broadcast field, Westinghouse acquired CBS; Disney acquired CapCities/ABC, and Fox acquired New World in multi-billion dollar transactions. Hundreds of radio stations have changed hands in transactions totaling hundreds of millions of dollars. In the cable industry, Time Warner is about to take control over Turner Broadcasting System for $7.5 bil-

lion, creating the largest media company in the world. Continental CableVision, the third largest cable operator, is being acquired by USWest for $10.2 billion.

The increasing concentration of ownership in the media raise significant questions about whether American consumers are receiving a diversity of views, or whether their information will be subjected to excessive control by a few corporations. These mergers also raise questions about the ability of independent voices to obtain access to the marketplace of ideas. And, finally, these media mergers raise competitive concerns about the ability of small broadcasters and independent programmers to compete in a highly-concentrated marketplace. CPI urges Congress to take a closer look at these issues in future hearings.

### III. ANALYSIS OF THE MERGERS OF TELECOMMUNICATIONS CARRIERS

Of all the mergers announced to date, the biggest mergers by far are those of Bell Atlantic and NYNEX, on the one hand, and SBC and Pacific Telesis on the other. If the mergers are permitted to go forward, both corporations will become two of the top corporations in the country and in the world.

The other significant merger in the telecommunications industry is the proposed merger of LDDS WorldCom, the fourth largest long distance company, and MFS Communications, the largest competitive access competitor to the incumbent local telephone companies.

CPI believes that the potential costs and benefits of each merger must be analyzed on a case-by-case basis. CPI does not believe that mergers in the telecommunications industry are necessarily harmful to consumers and competition. The following discussion presents an analysis of several of the factors that Congress may use to assess the impact of these mergers on competition and consumers.

*1. Efficiencies*

All of the major players involved in the mergers assert that the mergers of their companies will help them to reduce their costs and will make them stronger financially. For instance, Bell Atlantic estimates cost savings of at least $600 million annually. Most analysts agree that Pacific Telesis (PacTel) has been weakened by the spin-off of its cellular business and its reduction of intraLATA toll rates. The analysts generally agree that PacTel could benefit from its alliance with SBC, one of the strongest RBOCs.

If true, these costs savings and stronger financial backing would be beneficial to the companies. CPI is reluctant to second-guess the business judgments of the principals in these companies concerning whether these mergers are good for the companies. I would only note that some mergers have provided to be beneficial to the companies, while others, such as AT&T's acquisition of NCR, have not.

The important question for policy-makers, however, is not whether these mergers will benefit the companies, but whether the mergers will benefit consumers. If the mergers were necessary to keep the failing companies afloat so that consumers could continue to receive telephone service, the mergers would undoubtedly be beneficial for consumers. Consumers would also benefit if the cost efficiencies were flowed through to ratepayers in the form of lower rates for basic telephone services.

At most, however, the companies argue that the mergers will put them in a stronger financial position as they face increasing competition. CPI questions whether stronger, larger companies, particularly companies with monopoly power over local telephone service, will mean better service and lower rates for consumers, or simply greater profits for the principals and the shareholders.

*2. Jobs*

SBC-PacTel claim that the merger will result in over 1,000 new jobs in California, while Bell Atlantic-NYNEX assert that the merger may result in the loss of 3,000 administrative and management jobs, but no loss of blue collar jobs. It is not clear at this point whether the LDDS–MFS merger will create more jobs or lead to fewer jobs for the merged company.

It is ironic, to say the least, that the RBOC's would make these claims concerning jobs at the same time that they claim that the mergers will produce cost savings. Labor costs are one of the biggest operating costs of these companies. It is also of interest that the Communications Workers Association opposes these mergers due in part to its concerns about the effect on their union jobs. And while SBC-PacTel claim that they will add 1,000 jobs to California, it should be noted that SBC and PacTel have cut a total of about 11,000 jobs over the past few years.

Even though the loss of every job is important, policy-makers need to look at the effect on jobs in relation to the entire industry. According to Business Week magazine, AT&T and the RBOC's have cut about 250,000 jobs since the divestiture. Many of these jobs losses have been absorbed by increasing employment in other sectors

of the communications industry. In fact, according to Business Week, total industry employment has risen by 54,000 over the past two years alone, and the converging world of communications, computers, and entertainment has generated 400,000 new jobs in the past year, about 20% of the total new jobs in the economy.

*3. Loss of a competitor*

All three of these mergers will result in the loss of a potential competitor for local telephone service. Most analysts, and I suspect, most Members of Congress, assumed that the seven RBOC's would begin to invade each others' markets and compete with each other for local telephone service once the Telecommunications Act removed the barriers to competition. In fact, this expectation is explicit in the manufacturing section of the legislation which prohibits any RBOC from manufacturing in conjunction with another RBOC. (47 U.S.C. 273(a)) Similarly, it was assumed that LDDS would also begin to compete for local telephone service, and MFS was already a competitor. From this perspective, all three of the proposed mergers have a negative influence on the number of competitors.

But, it is not enough simply to examine the number of potential competitors. The analysis should also include an evaluation of the likely success that each of these competitors would have had on the market. While LDDS and MFS certainly have the desire to compete with the incumbent telephone companies, their actual ability to do so as separate entities is uncertain. As mentioned earlier, the rules of local competition are just being developed, and MFS and LDDS are relatively small companies compared to the RBOC's. While MFS has been providing competitive access service for the past few years, neither MFS nor LDDS has been providing basic local telephone service. Thus, while the LDDS–MFS merger reduces the number of potential competitors by one, it may not reduce the quality of the competition. In fact, there is an argument that the merger could strengthen the company's ability to compete for local service by providing greater revenues and greater amounts of investment capital.

With regard to the RBOC's, the obverse may be the case. RBOC's certainly have the financial ability to compete with each other; it is their desire to compete that is somewhat in question. The RBOC's have extensive experience in providing local exchange service and enormous revenues streams. The RBOC's average about $14 billion in annual revenues. They have the economic and political know-how to enter new markets, as they have shown with their extensive international investments.

The RBOC's already compete with each other for some services. Many of the RBOCs' cellular subsidiaries already compete with each other, as oftentimes both cellular licenses in a market are owned by an RBOC. USWest has applied to provide competitive telephone service to BellSouth in Atlanta, for instance. Bell Atlantic and NYNEX have already announced plans to provide long distance service outside of their regions, and NYNEX recently received approval from the California Public Utilities Commission to provide competitive long distance service as a reseller in that state.

At the same time, the RBOC's have also shown an inclination to join forces rather than compete. For instance, Bell Atlantic and NYNEX merged their cellular operations a few years ago, and these same cellular subsidiaries joined a consortium with USWest in an effort to provide seamless, nationwide mobile communications services in 1994. Bell Atlantic, NYNEX and Pacific Telesis have also joined to form TELE–TV, a new company intending to provide educational and entertainment programming over their "wireless cable" systems. SBC joined with Ameritech, BellSouth and the Disney Corporation in 1994 to create a similar programming entity.

It is difficult to predict at this time how strongly the RBOC's would compete with each other for local telephone service in the future if not for these mergers. Bell Atlantic and NYNEX would have been considered prime competitors because of their common interest in the New York City metropolitan market which adjoins the Bell Atlantic region in New Jersey. SBC owns cellular licenses in California, which could, at some point in the future, be used to compete with Pacific Telesis. Many observers believe that the future development of the market would have driven these companies to compete with each other in the future even if they did not have plans to compete at this time. But one point is certain—if these mergers are permitted, two of the most powerful, potential competitors will be removed from the marketplace.

In sum, while all three of the mergers reduce the number of potential competitors, the RBOC mergers would appear to create a threat to competition by eliminating from the competitive market two of the biggest potential competitors in terms of size and expertise in providing local telephone service.

*4. Market power*

One of the most fundamental differences between the LLDS–MFS merger and the RBOC mergers concerns their market power. Neither MFS nor LDDS have any leverage over the local telephone market or the long distance market. While MFS is the largest of the existing competitors for local telephone service, it has only about $600 million in annual revenues and is fighting to gain 1% of the market for local service. LDDS is the fourth largest long distance company, but it has less than 5% of the long distance market.

By contrast, the RBOC's having virtually 99% of the market for local telephone service where they provide service, and the RBOCs on average take in about $11 billion in annual revenues from their telephone services alone (not including their non-telephone business). The RBOCs are regulated both by the FCC and by their respective state commissions because they face so little competition that regulators must ensure that rates are kept at reasonable levels.

In short, the RBOCs have monopoly, or market power for local telephone service; LDDS and MFS do not. This alone presents a significant difference between the mergers for policy-makers. There is no possibility that the merger will allow LDDS to raise rates for its services or to thwart competition because consumers of LDDS services can turn to other providers to obtain lower rates. The RBOC mergers, on the other hand, strengthen the companies that already have a monopoly, or market, power over telephone service. If the RBOC mergers are permitted, strong action by federal and state policy-makers, becomes even more important in order to ensure that consumers do not suffer from higher rates as a result of the RBOC merger.

*5. Size*

The RBOC mergers would create two enormous entities. Bell Atlantic-NYNEX will have over $18 billion in annual revenues; SBC will have over $21 billion. The two companies will be the second and third largest telecommunications firms in the U.S., slightly behind AT&T. Before the Bell Atlantic-NYNEX announcement, analysts believed that the SBC-PacTel merger would be the fourth largest merger in the entire history of the U.S. The Bell Atlantic-NYNEX merger is even bigger. Now that AT&T has divested it manufacturing and computer operations. Bell Atlantic-NYNEX is almost as large as AT&T. Time Warner, which will become the largest media company in the world once it completes its acquisition of Turner Broadcasting, Inc., will still be smaller than either of the two merged companies, as will TCI, the supposed "giant" of the cable industry. The two merged RBOC's companies will each be approximately twice as large as MCI and Sprint, the second and third largest long distance carriers.

The sheer size of these new combined corporations is a concern for several reasons. First, it will make it more difficult for regulators to determine whether the company is engaging in cross-subsidization or other forms of improper cost-shifting. For example, one reason for breaking up AT&T in 1984 was that FCC officials testified that AT&T was so large that they could not prevent AT&T from engaging in cross-subsidization to keep out competitors.

Second, the added revenues means that the incumbent telephone companies have a greater potential to engage in predatory, below-cost pricing. When a monopolist faces the beginning of competition, a logical strategy is to lower its prices for competitive services below its costs. The monopolist may find that it is profitable to price certain services below cost in order to keep the competitor from growing and preserve its monopoly over other services. The monopolist can only afford to lose money on these few competitive services, however, if it is making enough money on its other, monopoly services to overcome the revenue shortfall from the competitive services. The larger the company is, the longer it can engage in such predatory pricing without suffering harm. It is also important to realize that the monopolist has incentives to engage in this behavior even if it is under some form of price regulation.

*6. Jurisdictional issues*

Another source of concerns about the mergers lies in the awkward lines of jurisdictional authority over the companies. In general, the FCC regulates the interstate portion of the carrier's business, while the states regulate the intrastate operations. States control about 75% of the total capital investment made by the telephone companies. By involving more states in the regulatory process for each of the merged companies, the mergers increase the difficulty that each state commission will have in reviewing the activities of the new, larger company. For instance, officials in the 14 states that must review the operations of USWest frequently note that the jurisdictional complexities can, as a practical matter, render regulatory review so difficult as to be ineffective. The merger of Bell Atlantic-NYNEX in particular en-

hances this concern because the merger will effectively double the number of states that will have the jurisdiction over the new entity.

*7. Conclusion of the merger analysis*

In conclusion, the RBOC merger, if permitted to go through, would appear to pose significant threats to the achievement of the goal of Congress to promote competition for local exchange telephone service. The LDDS–MFS merger, on the other hand, does not appear to raise the same level of concerns.

The benefits of the RBOC mergers in terms of cost savings are speculative, and in any case, may not be reflected in lower rates to consumers. The effect of these mergers on jobs is likely to be small in relation to the growth of jobs in the communications market as a whole. All three of the mergers remove one potential competitor in the market for local telephone service, but the two RBOC mergers each eliminate a stronger and more experienced potential competitor. The two RBOC mergers strengthen companies that already have market power over local telephone service, makes them into two of the largest corporations in the U.S. and the world, and makes state regulation of their activities more difficult. The combination of size and market power will give the merged RBOC's additional means with which to forestall competition with no assurance that any of the purported benefits of the mergers will be flowed through to consumers.

## IV. SAFEGUARDS

For all the above reasons, CPI believes that the proposed mergers of the RBOC's should not be permitted to go forward unless, at a minimum, additional measures are taken to develop competition and protect consumers. CPI suggests that policymakers should impose the following conditions before considering whether the mergers should be approved.

*a. Require each RBOC to satisfy the competitive checklist in each state in its region before the merger can be considered for approval*

As discussed above, the RBOC mergers are premature because they tip the balance in favor of concentration of ownership before competition for local telephone service has begun to be effective. In other words, these mergers increase the risk that competition will not develop for local telephone service. This risk should be counter-balanced by measures to make competition more likely for all consumers.

One way to restore the balance is to require the RBOC's to satisfy the checklist in Section 271 of the Telecommunications Act of 1996 in every state in its region before the merger can be considered for approval. Section 271 of the Telecommunications Act requires that each RBOC must open and unbundle its network to competitors for local telephone service in a state before being allowed to provide long distance service in that state. The Act does not require each RBOC to satisfy the Section 271 checklist in each state, however; the RBOC could choose to forgo the opportunity for long distance entry in a state if it believes that it will lose more revenues as a result of opening its local market to competition than it would gain from providing long distance service. For instance, while NYNEX is likely to attempt to satisfy the Section 271 checklist right away for the State of New York, it may not devote the resources necessary to satisfy the checklist in New Hampshire as quickly. Requiring the RBOC's to satisfy the Section 271 checklist in every state would force NYNEX to satisfy the checklist in each of its seven states, and Bell Atlantic in each of its territories (6 states and D.C.).

Requiring the carriers to unbundle their networks in all their states helps to protect against several of the dangers identified earlier. For instance, it would not be as easy for the combined companies to avoid state regulation if they face competition in all jurisdictions. Indeed, greater competition will reduce the need for state regulation. Similarly, it is more difficult for the carriers to price services below their costs in a competitive area, and make up the lost profits through higher prices in non-competitive markets, if every market faces potential competition.

It is important to note that this suggestion does not involve increasing the preconditions that the RBOC's must meet before they can provide long distance service. The Federal legislation specifically says that the FCC may not increase or expand the items contained in the checklist, and this proposal does not add to these long distance preconditions. CPI's suggestion relates to the merger applications, not the long distance applications. For instance, NYNEX might satisfy the checklist in New York and be able to originate long distance service in New York but may not be allowed to merge with Bell Atlantic if it has not complied with the checklist in the other states. In the alternative, NYNEX might meet the preconditions for the merger by satisfying the Section 271 checklist in each state, but may not yet provide long

distance service if, for instance, it fails to meet the "public interest test" under the legislation.

By requiring each of the four RBOC's to satisfy the Section 271 checklist in each state, the regulator would not have to make a determination of the carrier's market share or market power. Nor would this suggestion involve policy-makers in interpreting a new set of standards. Instead, this suggestion would rely upon the checklist already included in the legislation enacted by Congress. This pre-condition would simply rely upon the same decision that the FCC must already make under the legislation. As a result, this standard would not involve any increase in administrative resources by the FCC, by the States, by the Department of Justice, or by the carriers.

Finally, the carriers themselves have announced that they plan to meet the checklist requirements. The RBOC's supported passage of the legislation and are planning to comply with the checklist requirements, so the proposal would not impose any additional burden upon them. The pre-condition of ensuring that the RBOC's meet the Section 271 checklist is simply an added safeguard to ensure that the merged entity does its part to allow competition to develop in every state in their service areas.

Requiring the RBOC's to satisfy the Section 271 checklist in each state does not guarantee that competition will emerge in each state. Such a requirement, however, might increase the likelihood that competition would develop sufficient to offset the dangers to competition that the merger would create.

*b. Require the RBOC to flow through to consumers any benefits received from operating efficiencies*

As noted, the mergers could make it more difficult for regulators to determine whether the carriers are pricing their services according to their costs. The jurisdictional questions, as well as the doubling in size of the companies, will make regulation more difficult. These problems could make it easier for the carriers to charge rates to consumers that are higher than they would be otherwise.

One way to address this potential problem is to require the carriers to reduce their rates according to the amount of efficiencies they can expect will occur from the merger. Both carriers allege that the merger will make them more efficient and reduce their costs. It seems reasonable that regulators should require that the benefits of these efficiencies should flow through to consumers in the form of lower rates for service.

Unfortunately, it is unlikely that the carriers will flow through these savings to consumers unless regulators make such a cut in rates an explicit part of their approval process. Most states have implemented some form of price cap regulation that does not require the prices for service to be based directly on their costs. In other words, if carriers reduce their costs, they do not have to lower their prices to consumers. Regulators must take specific action to ensure that consumers benefit from the cost reductions achieved by the carriers as a result of the mergers.

*c. Additional safeguards*

CPI bases these conclusions on the information concerning the mergers that is available at this point in time. Several regulatory agencies are reviewing these mergers, including the Department of Justice, the FCC, and certain state regulatory commissions. It is possible that further information concerning these mergers will arise in the course of those proceedings. CPI will monitor these investigations to determine whether additional action may or may not be necessary.

## V. CONCLUSION

CPI understands that U.S. companies must prepare to meet the challenges of the 21st Century. The markets for telephone services, entertainment services, computer services are converging. Many of these companies believe that they need to prepare for the future by aggregating products and services so that they may provide "one-stop shopping" to consumers. CPI understands and is not opposed to the desire of companies to provide one-stop shopping and other consumer services. CPI simply urges this Committee and other policy-makers to make certain that consumers can choose from several competing providers, each of whom is able to sell services both individually and as part of a package. CPI believes that the goals of the Telecommunications Act were correct—to promote a more competitive, deregulatory marketplace for telecommunications goods and services. Recent developments, and in particular the proposed mergers between several of the RBOCs, threaten the achievement of those goals. Before allowing these mergers to go forward, policy-makers should take steps to ensure that the RBOCs take more effective steps to promote competition for local telephone services and to ensure that consumers bene-

fit from at least some of the cost savings that these mergers are intended to produce.

Senator THURMOND. Mr. Hatfield.

## STATEMENT OF DALE N. HATFIELD

Mr. HATFIELD. Thank you, Mr. Chairman. I appreciate the opportunity to testify before you today on the subject of mergers and competition in the communications industry. I have already submitted written testimony, and in accordance with your instructions I will only summarize that testimony here this afternoon.

Let me begin by stating for the record that while my firm has done some work for the incumbent LECs from time to time, we also have done quite a bit of work for long distance carriers and others who seek to compete in the local market.

In my testimony here today, I will focus on two areas; one, my concerns about the prospects for robust competition in the provision of local telephone service; and, two, given those concerns, the public interest implications of the proposed mergers between Bell Atlantic and NYNEX and between SBC and PacTel.

Over the past 25 years or so, of course, competition has been successfully introduced in the customer premises equipment and long distance portions of the communications marketplace. Competition in the local telephone segment, of course, was held back by a combination of factors, including legal barriers to entry and the massive size of the initial investments required to duplicate the existing local exchange network. Thus, despite local telephone predictions to the contrary, the degree of local competition has remained trivial.

In passing the Telecommunications Act of 1996, of course, this Congress took critical steps to facilitate the development of competition in the provision of local services. It did so by affirming the policy of relying upon competition in communications generally, and more specifically by legislating against statutory and regulatory barriers to entry, by establishing the legislative groundwork for economical and nondiscriminatory interconnection agreements and, among other things, legislating against unnecessary and unfair unbundling and resale restrictions.

Recently, of course, as we have heard, the FCC took important steps to achieve the procompetitive goals of the act. But despite these critical steps by the Congress and the FCC, I continue to have strong reservations about whether robust competition, with multiple facilities-based providers of local service, will actually develop. My reservations stem from two things.

First, I am concerned that unlike the situation in long distance and equipment manufacturing sectors of the market following divestiture, the Bell operating companies have a strong incentive to impede competition in their core market, the provision of local exchange and exchange access services.

Second, while striking down statutory and regulatory restrictions and eliminating or reducing other barriers to entry—while these are necessary conditions, they may not be sufficient to ensure the development of robust local competition. They may not be sufficient because of the enormous cost of creating multiple local communica-

tions networks and the high risks associated with gaining sufficient market penetration to achieve reasonable economies of scale.

Thus, my conclusion is that, despite this Congress' commendable efforts to promote competition in all segments of the industry, the prospects for robust local competition are highly uncertain, at best. Because of this uncertain outlook, I believe strong legislative and regulatory oversight is absolutely essential to protect consumers and emerging competitors against the exercise of monopoly power.

More specifically, because of the nascent, limited and fragile nature of the emerging competition, I believe the proposed mergers among industry giants should be given especially close scrutiny, lest they further entrench incumbent local providers and thwart the procompetitive deregulatory climate that you tried so hard to create.

Against this backdrop of uncertainty about the prospects for local competition, I would like to turn my attention to the proposed mergers. Based upon my analysis of the situation, I have reached three fundamental conclusions regarding the mergers.

First, I have concluded that the Bell operating companies indeed are best positioned to serve as pathfinders or trailblazers in the road to increased local competition outside their operating territories. Second, because of their unique positions to compete outside their regions, and given the uncertainties regarding possible competition from other entrants, I further conclude that the proposed mergers will significantly diminish the prospects for future competition in the local market.

Indeed, it was my expectation, perhaps naively, that with the passage of the act, the BOC's and the other incumbent local carriers would aggressively expand outside their respective operating territories and begin to compete head to head with one another. The proposed mergers drive a stake in the heart of those hopes.

Third, the reduction in the total number of BOC's with the proposed mergers will decrease the future effectiveness of both benchmark regulation and benchmark competition. The present industry structure involving multiple BOC's facilities regulatory and competitive comparisons or benchmarking to the benefit of all consumers.

Thus, I have concluded the proposed mergers will significantly diminish the prospects for local competition, as well as decrease the effectiveness of both benchmark regulation and benchmark competition. Hence, I strongly recommend that the Department of Justice and the other Federal and State authorities give the proposed mergers the closest possible scrutiny.

That concludes my testimony, Mr. Chairman. I would be happy to answer any questions you or your colleagues might have.

[The prepared statement of Mr. Hatfield follows:]

PREPARED STATEMENT OF DALE N. HATFIELD

INTRODUCTION

Thank you Mr. Chairman. I very much appreciate the opportunity to appear before you today to testify regarding mergers and competition in the telecommunications industry. I have been involved in the telecommunications policy arena for about twenty-five years and it is from that perspective that I offer this testimony.

It is obvious, of course, that we are not in the midst of a particularly critical period of time—a period of time during which actions taken in the private sector and

decisions taken in the public policy and regulatory sectors will have a profound and long term influence on the development and deployment of advanced telecommunications and information technologies. More specifically, these actions and decisions will play a crucial role in determining whether the American public will actually enjoy the benefits associated with opening all telecommunications markets to competition as contemplated by the passage of the Telecommunications Act of 1996 earlier this year.

Before I present the substance of my testimony, I thought it might be useful if I briefly summarized my experience in the telecommunications policy field. One of my earliest positions was Deputy Chief of the Office of Studies and Analysis in the Office of Telecommunications Policy, Executive Office of the President. From there, I went to the Federal Communications Commission (FCC) where I became Chief of the Office of Plans and Policy. After serving at the FCC, I went to the National Telecommunications and Information Administration (NTIA) in the U.S. Department of Commerce, where I became Chief of the Office of Policy Analysis and Development. Subsequently, I became Acting Assistant Secretary and then Deputy Assistant Secretary of Commerce for Communications and Information and Deputy Administrator of NTIA. I left government nearly 15 years ago and established a telecommunications consulting firm in Boulder, Colorado. We have grown to where we now employee eight full-time professionals with advanced degrees in engineering, economics, business, and law.

While we have provided consulting services to incumbent local telephone companies from time to time, the principal part of our consulting work in this area has been on behalf of long distance carriers and firms seeking to compete in the provision of local telecommunications services. In addition to serving private sector clients, I have also served as a consultant to the Department of Justice, to state governments, and to foreign governments regarding issues of telecommunications policy.

In my testimony here today, I will focus on two areas: one, my concerns about the state of—and prospects for—competition in the provision of local telephone service and, two, given those concerns, the public interest implications of the proposed mergers between Bell Atlantic Corporation ("Bell Atlantic") and Nynex Corporation ("Nynex") and between SBC Communications, Inc. ("SBC") and Pacific Telesis Group ("PacTel").

## PROSPECTS FOR LOCAL COMPETITION

Over the past twenty-five years or so, competition has been successfully introduced into the customer premises equipment and long distance telecommunications markets. I attribute this success to three major things: (1) the striking down of legal prohibitions on competition in these two segments of the telecommunications market, (2) the lack of significant economies of scale or natural monopoly characteristics in either of the two segments, and (3) the divestiture of the Bell Operating Companies from AT&T and the accompanying line-of-business restrictions that reduced the incentives of the divested BOCs to use their market power to discriminate against participants in the two segments.

Competition in the local telephone segment of the telecommunications market has been held back by a combination of factors including: (1) legal barriers to entry at the state level, (2) the massive size of the initial investments required to duplicate the existing local exchange network infrastructure, (3) difficulties in gaining the necessary interconnection arrangements with the incumbent local exchange carriers and in obtaining needed rights-of-way, (4) unnecessary bundling and resale restrictions imposed by the incumbent local carriers, and (5), more generally, difficulties in overcoming the natural monopoly characteristics of local telecommunications networks. Thus, despite local telephone company predictions to the contrary, the degree of local competition has remained trivial.

In passing the Telecommunications Act of 1996, this Congress took critical steps to facilitate the development of competition in the provision of local telecommunications facilities and services. It did so by affirming the policy of relying upon competition in telecommunications generally and, more specifically, by legislating against statutory and regulatory barriers to entry, by establishing the legislative groundwork for economical and non-discriminatory interconnection arrangements, and, among other things, by legislating against unnecessary and unfair bundling and resale restrictions. Recently, in CC Docket No. 96–98, the Federal Communications Commission took important first steps to achieve the pro-competitive goals of the 1996 Act. Despite these critical steps by the Congress and the FCC, I continue to have strong reservations about whether robust competition in the provision of local telecommunications services will actually develop.

My reservations stem from two things. First, I am concerned that, unlike the situation in the long distance and equipment manufacturing sectors of the market following divestiture, the Bell Operating Companies have a strong incentive to impede competition in their core market—the provision of local exchange and exchange access services. Indeed, given the trivial amount of local competition that exists today, they not only have the incentive, but they also have the power to impede competition. Second, while striking down statutory and regulatory restrictions and eliminating or reducing other barriers to entry are necessary, they may not be sufficient to ensure the development of robust local competition. They may not be sufficient because of the enormous cost of creating multiple local telecommunications networks and the high risks associated with gaining sufficient market penetration to achieve reasonable economies of scale.

These two conditions—the difficulties in dealing with highly entrenched incumbent carriers who have a strong incentive to impede competition and the cost of actually duplicating the existing local telecommunications network and achieving reasonable economies of scale—coupled with some remaining technological uncertainties and risks associated with alternative local exchange networks, explain in large part why local competition is still not developing rapidly or extensively. Moreover, our firm's economic modeling suggests that the incumbent local telephone companies' cost of providing local service is substantially lower than the corresponding price in many geographic areas in which other providers may wish to compete. As a result, the incumbent local telephone companies are in a strong position to reduce prices when and where entry is threatened.

In short, the required investments in alternative local exchange networks are not only large but highly risky as well. The magnitude of the investment and the high risks involved go a long way in explaining why (1) the cable industry has apparently pulled back from full-scale telephony deployment and is focused more on providing Internet access services and on expanding and protecting their core business of delivering entertainment video programming, (2) the emerging wireless Personal Communications Service providers appear to be focused almost entirely upon competing with existing cellular mobile radio carriers rather than providing ordinary local telephone services, and (3) the competitive access providers (CAPs) still seemed focused on providing switched and dedicated transport services to business customers in limited—typically downtown—areas. In this regard, it is important not to confuse glowing press releases on limited market tests and premature technology "hype" with firm commitments by organizations with substantial financial and technical resources to actually construct alternative networks on a ubiquitous basis.

Thus, my conclusion is that, despite this Congress' commendable efforts to promote competition in all segments of the telecommunication industry through passage of the 1996 Act and the Commission's commendable first steps to develop policies and rules to facilitate that competition, the prospects for robust local competition are bleak at worst and highly uncertain at best. Because of this bleak, or, at best, uncertain outlook, I believe strong legislative and regulatory oversight is absolutely essential to protect consumers and emerging competitors against the exercise of monopoly power. More specifically, because of the nascent, limited, and fragile nature of the emerging competition, I believe proposed mergers among industry giants should be given especially close scrutiny lest they further entrench incumbent local providers and thwart the pro-competitive, deregulatory climate that your tried so hard to create.

## EFFECTS OF THE PROPOSED MERGERS

Against this backdrop of uncertainty about the prospects for local competition, I would now like to turn my attention to the proposed mergers between Bell Atlantic and NYNEX and between SBC and PacTel. Based upon my analysis of the situation, I have reached three fundamental conclusions regarding the proposed mergers.

First, I have concluded that the BOCs are especially advantaged as potential out-of-region competitive entrants into the local exchange and exchange access markets. Not only do they have the overall advantage of having operated local telephone networks for decades, the BOCs, including the four that are currently planning to merge into two companies, have significant advantages in terms of (a) gaining access to the massive capital resources necessary to construct alternative networks on a ubiquitous basis throughout a region, (b) their knowledge of, and experience with, the technical and economic aspects of interconnection and (c) their knowledge and experience with billing and Operational Support Systems that are vital to the provision of local telephone services. Therefore, the BOCs are uniquely positioned to serve as "pathfinders" or "trailblazers" on the trail to increased local competition outside their current operating territories.

Second, based upon the first conclusion, and given the entrenched position of the BOCs within their respective regions and the uncertainties regarding possible competition from other entrants, I further conclude that the proposed mergers will significantly diminish the prospects for future competition in the local exchange and exchange access markets. Indeed, it was my expectation—or, at least, my fervent hope—that, with the passage of the 1996 Act, the Bell Operating Companies and other incumbent local exchange carriers would expand outside their respective operating territories and begin to compete head-to-head with one another. The proposed mergers drive a stake in heart of those hopes and expectations. Once consummated, only antitrust action would have any hope of restoring the possibility of that competition.

Third, the reduction in the total number of BOCs through the proposed mergers will decrease the future effectiveness of both benchmark regulation and benchmark competition. Let me explain what I mean by these terms. While the BOCs frequently march in lock step, differences do arise in terms of, among other things, (a) their regulatory strategies and tactics and (b) their choice of technologies and services. As an example, NYNEX, in the face of regulatory pressure, showed an early willingness of collocate Competitive Access Provider equipment in their local central offices. That willingness, no matter how reluctantly produced, aided emerging CAPs and policy makers and regulators in other regions in establishing the technical and economic feasibility of collocation.

Likewise, the BOCs have differed in terms of their choice of technology platforms and service offerings. For example, some BOCs have been strong proponents of the use of fiber optic technology to offer broadband services while others have favored the use of a new technology that relies upon expanded use of today's copper technology. Still others have unveiled strategies for relying upon microwave radio techniques for delivering broadband entertainment programming. There may be good business reasons why the BOCs choose different technology platforms and different service offerings, but, given their market power, the regulator cannot be assured that the choices are always in the best interests of the BOCs' customers. These differences give policy makers and regulators, as well as intervenors in regulatory proceedings, the opportunity and factual basis with which to challenge those choices and to prod or cajole them to improve their performance accordingly. Such challenges can lead, for example, to more efficient forms of interconnection, better technology choices, and wider availability of important services.

Differences in BOC technology and service choices also produce a form of benchmark or yardstick competition. For example, residential or small business subscribers desiring economical digital connections to the Internet can put pressure on their local BOC to provide such services (or to provide them in a more user-friendly way), based upon popular or trade press accounts of the offerings and performance of other, out-of-region BOCs. More telling, large business or government customers with multiple locations and high value communications traffic, can use their experience in one region to pressure their provider in another region to improve performance or to offer different services. Even more to the point, with multiple regional BOCs, a large financial services firm can, for example, threaten to move its communications-intense "back office" processing facility served by NYNEX in Manhattan to a nearby location in New Jersey served by Bell Atlantic. By this means, the customer can indirectly pressure the incumbent local carrier to improve performance or lower prices.

## SUMMARY AND CONCLUSIONS

In summary, I have concluded, Mr. Chairman, that, despite Congressional efforts to promote competition in all segments of the telecommunications industry through passage of the 1996 Act, the prospects for robust local competition are highly uncertain at best. Because of this highly uncertain outlook, I believe strong legislative and regulatory oversight is absolutely essential to protect consumers and emerging competitors against the exercise of monopoly power by the incumbent local exchange carriers.

I have also testified that (1) the BOCs are uniquely situated to act as pathfinders or trail blazers in introducing competition outside their current regions, and (2) the present industry structure involving multiple BOCs facilitates regulatory and competitive comparisons or benchmarking to the benefit of all consumers. I have therefore concluded that the proposed mergers will significantly diminish the prospects for competition in the local exchange and exchange access markets as well as decrease the effectiveness of both benchmark regulation and benchmark competition. The importance of these consequences can hardly be overstated given the uncertain prospects for local competition. Hence, I strongly recommend that the U.S. Depart-

ment of Justice and other federal and state authorities give the proposed mergers the closest possible scrutiny.

That concludes my testimony Mr. Chairman and I would be happy to answer any questions you or your colleagues might have.

Senator THURMOND. Mr. Crandall states in his written testimony that efficiencies from the Bell mergers, "would be reflected in lower rates for consumers." Could you each please state whether you believe the Bell companies can be expected to pass the savings through to consumers instead of simply increasing their profits prior to competition developing in local telephone markets?

Mr. Crandall.

Mr. CRANDALL. Oh, you want to start with me? I thought you were going to ask them to criticize my point of view. Mr. Chairman, it is a standard maxim and theorem in economics that even in a monopolistic industry, declines in costs are passed through to consumers. In any industry, chances are these costs would be passed through unless they served as some sort of a signaling device to keep prices up.

I think there are likely to be substantial efficiencies from a variety of combinations. I don't think we today can know where they come from. As long as the mergers themselves do not reduce actual competition and as long as these companies are not the unique potential entrants into the other's markets—matters which, as Mr. Huber suggested, will be tested before antitrust authorities—there is no reason to stop them and we ought to just wait and see. I believe there will be efficiencies and I do believe that under any market structure they will be passed through to consumers.

Senator THURMOND. Does any other member wish to comment on that? Mr. Binz.

Mr. BINZ. Senator Thurmond, I would take exception with that. For 11 years, I was a consumer advocate in Colorado. I never saw a utility volunteer to pass through cost savings once. It was up to the regulators to do that. Now, once they are subject to competition, I will agree that they will be forced to bring their costs down. I think if Mr. Crandall's prediction were true, then the Bell operating companies who are the subject of these merger discussions would then agree with the proposal that CPI is making here, namely that they commit to reduce rates reflecting the $900 million annually in savings that the Bell Atlantic-NYNEX is claimed to generate. I do not think, however, prior to being subject to true competition in a region that consumers will expect to see those efficiencies flow through.

Senator THURMOND. Mr. Huber, do you care to comment on this?

Mr. HUBER. Well, we don't completely have to speculate about this. Mr. Hatfield suggested that it was the 1996 Act that permitted these mergers to happen. But, of course, the 1996 Act had no impact whatsoever on the legality or otherwise of merging local phone companies, and Bell Atlantic and NYNEX did, in fact, merge part of their operations some time ago. They merged their cellular operations, and anybody who seriously studied, not just rhetorically chatted about that merger, will have to say that the signs there are pretty good.

Now, it is correct that the cellular market is driven by larger competitive forces at the moment than the land-line market, but I

don't think anybody disputes that new entry is happening in the local land-line business, and where prices are not already below cost—and they won't drop any further below cost if they are already below cost, but where that is not the case, yes, savings will be passed on when competitive pressure forces that.

Senator THURMOND. Mr. Hatfield, do you care to comment on that?

Mr. HATFIELD. Yes. I mean, I think one of the very good reasons that the prices of cellular have come down, of course, is because of the FCC license to additional providers of cellular service right here in the district, and that has put competitive pressures on. What I am saying in my testimony is I have very serious doubts that certainly in the next few years we will see a lot of competitors, and absent those competitors, then I don't believe these sorts of efficiency gains will be passed through to consumers.

Senator THURMOND. Now, could each of you comment briefly on whether you think the telecommunications industry has received the clear guidance it needs to know how to position itself in the marketplace and invest in the new technologies, and what impact do you believe the appeals of the recent regulations of the Federal Communications Commission will have?

We will start with Mr. Huber.

Mr. HUBER. Well, I think this is an industry that could use a lot less guidance from both Congress and the FCC. I would like to see competition providing more of the guidance and regulators less. The fact is Congress wrote a pretty complicated law earlier this year and the FCC has written even more complicated regulations trying to implement it and thrashing that out is going to take some time. It is a pity it can't be done faster, but basically we are correcting 60 years of bad regulatory policy and it will take a year or two to work that out.

Senator THURMOND. Mr. Crandall.

Mr. CRANDALL. Senator Thurmond, I think as I indicated in my oral remarks, I don't think very many people know where things are going to settle out in the telecommunications sector and, as a result, I don't think anybody could give these companies guidance. We are embarked upon a competitive strategy which is, in a sense, a grand experiment. No one else has done this in the world, with the possible exception of New Zealand, and they have spent 5 years fighting in the courts about it, so we haven't even gotten any guidance from them.

I don't think it is possible to provide guidance in a market which is being opened up to competition and in which technology is changing so rapidly. I think these are very, very uncertain times for telecommunications providers and I think they have to be very careful as to how they move.

Senator THURMOND. Mr. Binz.

Mr. BINZ. Senator Thurmond, I think the FCC faithfully interpreted the statute which Congress passed. The incumbent monopolies didn't like the result they got and that is why they have gone to the court on appeal on this. I think the rules are sufficient and I think they are clear, and I think the FCC recognizes the same thing that Congress did, namely you can't just remove the barriers to competition and expect that they happen magically. You have

got to do some work to get it when you are living with a legacy of a very entrenched monopoly. I think the FCC's rules do that. I am very dismayed by the stay because I think this does put a roadblock in the way to competition. Hopefully, the courts will not grant the stays and eventually the FCC will prevail in the appeals.

Senator THURMOND. Mr. Hatfield.

Mr. HATFIELD. I think there are three major rulemakings. I believe the Commission refers to them as the trilogy, and as Mr. Binz just mentioned, of course, the FCC did come out with a decision that is being challenged, of course, and that was in the local competition interconnection issues. But we have left, of course, the universal service proceeding and then a very, very important access charge reform proceeding. Until, I think, we get all three in place, I think one cannot say that the rules are clear.

Senator THURMOND. Mr. Huber, given your view of the expanding nature of telecommunications markets, do you think that every merger which might be proposed in the industry should be permitted? If not, where would you draw the line?

Mr. HUBER. Well, I itemized three or four in my opening remarks. I mean, clearly, we would not want Bell Atlantic to acquire TCI's cable property in Washington, DC. We wouldn't want Bell Atlantic and SBC to merge their cellular properties in Washington, DC. Where there is a single geographic market and truly competitive products, of course, you are not going to allow them to merge unless it is very small players merging to become a more viable competitor.

So there is plenty of opportunity to enforce the antitrust law with intelligently defined product markets and geographic markets, but very little of our discussion today has even bothered to articulate what product is competing against which product and in which geographic area. Until you do that, no intelligent antitrust analysis is possible.

Senator THURMOND. Does any other member wish to comment on that?

Mr. BINZ. Senator Thurmond, in my written testimony I discuss the LDDS–MFS merger proposal, distinguishing that from the merger of companies with market power, like Bell Atlantic and NYNEX. I think there are distinctions that can be made. I think, arguably, creation of a vertical integration of the kind that LDDS and MFS are proposing may, in fact, create a more viable competitor, one who is able to go up against NYNEX in its own territory.

However, I think the horizontal mergers, especially when you get into a situation like a market like New York City, which has been discussed here today, I think those are problematical. I know the Department of Justice will perform its duty in reviewing that.

Mr. CRANDALL. Could I just respond to that briefly? There is very little in the way of horizontal issues in this case and the major issue is going to be over potential competition, not horizontal integration by two competing carriers.

Senator THURMOND. As I noted in my opening statement, mergers are illegal under the antitrust laws only if the effect may be to substantially lessen competition. In other words, mergers are to be permitted under the antitrust laws as long as the effect on competition is neutral or causes minimal harm.

Mr. Binz and Mr. Hatfield, while you clearly do not favor the two Bell mergers, do you believe that their effect may be to substantially lessen competition?

Mr. BINZ. Senator Thurmond, I think what is relatively unique about the situation we are talking about is we have just opened a market to competition, namely local exchange service. We have removed legal barriers which have been in place in some cases for decades. I agree with the sentiment expressed by Mr. Crandall that we don't know how this is going to develop. In that circumstance, it is very difficult perhaps to assess precisely the effect that mergers of the sorts that we are discussing here have had.

But I think it is undeniable that there is some effect on the competitiveness of segments of this market. It needs to be investigated. I am not an antitrust expert and wouldn't propose to say here today whether that threshold which you announced has been exceeded. I think, though, it is undeniable and I think it is frankly incredible to think that Bell Atlantic and NYNEX would never have had designs on each other's markets. That is tantamount to saying that no Bell is going to compete with any Bell. I think that needs to be examined very closely. I think the suggestion that we made that that be tied to the opening of their markets via imposition of the 271 requirements as a pre-condition to merger is an approach to that.

Senator THURMOND. Mr. Hatfield.

Mr. HATFIELD. Yes. Well, these companies have had 100 years of experience in providing local telephone service and the thought that they are somehow not uniquely qualified based upon that experience to compete with one another I just don't understand. Therefore, it is my conclusion that this will significantly lessen competition.

Senator THURMOND. Now, would any of you care to comment on the view that, despite their dominant position, the Bell companies are not fierce competitors in the marketplace because they have grown complacent from years of regulation?

Mr. CRANDALL. Well, I will comment on that, Senator. I mentioned in my oral remarks and in the response, I guess, to Senator Leahy that any time a company is protected from competition and engaged in the regulatory process, they have some difficulty in adjusting to an openly competitive world. All you have to do, I suppose, is to ask former airline executives who practice before the CAB how well they did once competition was opened up.

The idea that they have some sort of unique advantage, though, as Mr. Hatfield suggested, in providing this service because they have provided it under a regulatory umbrella for many years, I think, may even be belied by studies that Mr. Hatfield's own organization is making today which suggest that a new entrant could enter at maybe half the cost of these local exchange companies. If your costs today are twice the costs of what a potential entrant has, that is some advantage.

Senator THURMOND. It seems that we are in an exciting period in which many new competitors will be entering the marketplace and offering new services. While this is a positive development, it also may lead to a certain amount of frustration and confusion among consumers and more marketing calls during dinner time. Do

any of you have any advice or encouragement for consumers, other than to grin and bear it?

Mr. HUBER. Shop around. You will find better deals.

Mr. CRANDALL. Once again, as I mentioned in my opening remarks, one of the reasons for those calls, particularly from long distance companies, is that the price/cost margin, price over the incremental cost of providing the network services, is so enormously high. I think once the prices come down due to competition, you will get fewer calls asking you to switch in return for a check of $50 or $100.

Mr. BINZ. Senator Thurmond, I would add that I think that help is on the way to some extent with the integration of service offerings by providers. I think that is going to be—rather than competition for your attention for long distance and, separately, competition for your attention for Internet supply or competition for local service, packaging of services is probably going to provide some relief. I just saw a study announced last week that a very high percentage of people want something we have all been saying here; namely, one-stop shopping is preferred. I think that is one point that is going to help.

The second point I would make is that the FCC, pursuant to the new law, is promulgating rules on the use of information collected about consumers for purposes of marketing other products. CPI has endorsed fairly restrictive conditions on which that information can be used, and I think if the FCC follows through on its notice of proposed rulemaking on customary proprietary network information, that will also curtail some of the proliferation of calling lists that are developed through that kind of information.

Senator THURMOND. Mr. Hatfield.

Mr. HATFIELD. I don't have anything to add to that.

Senator THURMOND. Now, do any of you have any further statements you would like to make before we close this hearing? Mr. Hatfield.

Mr. HATFIELD. Well, if I could, I think it is awfully important to focus on this notion that in your home in South Carolina or my home in Colorado, it is really realistic to think in the next few years, at least, that there are going to be two or three wires run in there by different people, or there are going to be different bay stations placed in my home so that I have a choice of five or six different local telephone companies. I just simply do not believe that is in the cards. Therefore, in my opinion, any notion that this is going to become a highly competitive local market in the short term is just simply not true.

Senator THURMOND. Mr. Binz.

Mr. BINZ. Senator Thurmond, very quickly, I would just say that you might have the impression from the panels that preceded this one, with all the discussion about interconnection negotiations and agreements, that there is some, in some sense, rampant competition for local services. I am here to report that that is not the case yet. Hopefully, it will be some day.

Although it is a strange word to apply to these Fortune 500 companies, the word "fragile," in fact, I think the market structure that we need to have developed to have local competition is fairly fragile. The kinds of rules that the FCC is adopting which are intended

to create a market to create the playing field in which the market can grow is very important. That is why we are here today. Again, Senator Thurmond, I appreciate very much your calling a hearing to look at these issues because I think we are at a turning point as to whether local competition actually does proceed the way Congress hoped it would when it passed the legislation earlier this year.

Senator THURMOND. Does anybody else have any statement they would like to make?

Mr. HUBER. If I could just end by summarizing what I think I just heard to my left here, on the one hand, competition is impossible, it won't happen, there is no prospect for it whatsoever; and, second, the prospects for competition will be severely diminished if these mergers are allowed to proceed. Now, you can have one or the other, but you can't have both.

Mr. CRANDALL. Let me just also conclude by saying that I perhaps agree with Mr. Hatfield that the prospects in the short term for someone coming in and building all new facilities, wire-based facilities in local markets, may not be very bright. I think they have been dimmed substantially by the possibility that the unbundling and resale requirements of the FCC are what they are and make it so attractive to be a reseller.

But, also, we have to keep in mind that there is a prospect of wireless competition, and that is a real prospect. The fifth, or maybe the sixth, depending on how you are counting, entrant into that business collectively for a nationwide license just bid $10 billion just for the spectrum to offer that service. Even if the present value of that is only $4 or $5 billion, that is a huge amount to pay for the right to enter as the fifth or sixth competitor offering wireless service against the wire-line companies. I think we are going to see real wireless competition before very long for the wire-line companies.

Senator THURMOND. Mr. Hatfield.

Mr. HATFIELD. Could I just add a thought to that, though? In my looking at what the so-called PCS providers are actually offering, essentially it is up-banded cellular. It is essentially to compete with the cellular carriers. As far as I know, there has been almost nobody that is really proposing a true wireless local loop that replaces in a fixed sense. It is more to compete with the cellular carriers. So, therefore, the prospects for true wireless local loop competition, again, I think are a long way off.

Senator THURMOND. We will leave the record open for 1 week for members to submit statements. Additionally, members may have written follow-up questions for the witnesses.

I wish to express my deep appreciation to all of you witnesses who have testified here today. I think your presence here and your testimony has been very helpful to this committee.

Now, if there is nothing further, we stand adjourned.

[Whereupon, at 5:12 p.m., the committee was adjourned.]

# APPENDIX

## QUESTIONS AND ANSWERS

### RESPONSE OF JAMES R. YOUNG TO QUESTION FROM THE SENATE COMMITTEE ON THE JUDICIARY

*Question.* What impact will your merger have on consumers? What impact will your merger have on your ability to compete in international markets? In the long distance market?

Answer. I believe that the merger will be good news for consumers, as it will bring them new and better services at competitive prices.

The new Bell Atlantic will be large in absolute size, but small in comparison to the telecommunications giants of the world. Individual companies such as AT&T Nippon Telephone and Telegraph and Deutsche Telekom are all larger than the merged company will be. Even after AT&T's divestiture, it will be twice as large as the new Bell Atlantic. These international giants are also teaming up into global alliances like the AT&T World Partners, MCI's and British Telecom's Concert, and Global One of Sprint, France Telecom and Deutsche Telekom.

The location of the new Bell Atlantic, serving both the political and financial capitals of the United States, makes the company a natural challenger to these multinational powerhouses. Bell Atlantic and NYNEX customers make about 35 percent of the international calls from the United States, and we want to be able to begin to provide competition for these customer's business.

The new Bell Atlantic will be a good competitor at home. We intend to fulfill the promise of the Act by bringing competition to the domestic long distance market that has been dominated by AT&T, MCI and Sprint. We expect that the combined Bell Atlantic/NYNEX will be a better competitor than either company could have been on its own.

### RESPONSES OF JAMES R. YOUNG TO QUESTIONS FROM SENATOR THURMOND

*Question 1.* Mr. Young and Mr. Ellis, many commentators seem to view the two pending Bell mergers as identical. Would either of you care to address differences between the two mergers in light of the various competition issues which have been raised?

Answer 1. I believe that the two mergers are the same in terms of the competition issues. In both cases, the proposed merger partners do not compete with each other today. Other than perhaps in their entering the national long distance market place, dominated today by the Big Three long distance companies, they had no plans to compete against each other in any market in the future.

*Question 2.* Mr. Ebbers, to what extent do you consider the merger between WorldCom and MFS to be "defensive" or compelled by changes such as the Bell mergers? Do you think that larger telecommunications companies will enhance competition and create greater efficiencies for the benefit of consumers?

Answer 2. Not applicable.

*Question 3.* Mr. Ebbers, do you expect MFS ever to begin offering service to residential customers, rather than simply to business customers? How do you respond to assertions that targeting beg customers first is "cream skimming"?

Answer 3. Not applicable.

*Question 4.* Mr. Ellis and Mr. Young, how soon do your companies and your merger partners expect to be able to offer inter-LATA long distance service in every state in your regions?

Answer 4. Both Bell Atlantic and NYNEX individually, and the new merged Bell Atlantic, plan to meet the competitive checklist as soon as possible and promptly thereafter to file applications with the FCC for permission to provide in-region long distance service. At this point, we expect to begin filing these applications early next year.

*Question 5.* Mr. Ellis and Mr. Young, when do you expect widespread local exchange competition for business and residential customers to occur in your regions?

Answer 5. The exact timing of widespread competition, especially competition in the residence segment of the market, is in the hands of the competitors, such as Mr. Ebbers' company. Because of the rate structures established under existing regulatory regimes, I would expect to see broad competition for business customers before comparable competition in the residence sector.

Many firms are entering the local telephone business. In New York, there are already nearly 50 exchange carriers certified to do business. There are somewhat fewer in Northern New Jersey, and there are significant numbers in Boston, Philadelphia, Pittsburgh, Washington, D.C., and Baltimore. These competitors include the likes of AT&T, MCI, Time Warner and MFS. Even SBC has said that it intends to compete in our territory, as it already has a presence there.

*Question 6.* Mr. Young, you indicate in your written testimony that New York City is one of the most intensely competitive telecommunications markets, with over twenty local exchange and access service providers. Could you give us some indication of what share of the local exchange market those companies currently hold?

Answer 6. NYNEX has no way of knowing what share of the local market the competitive local exchange service providers serve. Looking at some of the data that are available publicly, the following information gives a good indication of the state of competition in New York City and Manhattan:

There are nearly 50 competitive local exchange carriers certified by the New York Public Service Commission to provide local exchange service. There are also an additional 23 wireless service providers licensed to provide local exchange service.

There are 11 competitive local exchange switches operating in the New York City market. These switches have an estimated capacity of 1.3 million lines.

Based on one market survey, NYNEX had 46.5% of the high capacity DS 1 and DS 3 service circuits in Manhattan and 54.3% in New York City. NYNEX's share of the slower speed DS 0 circuits is 61.2%.

NYNEX has assigned 710,000 telephone numbers, or 71 NXX codes, to competitive carriers serving New York City.

Competitive carriers have located 45 physical collocation nodes in NYNEX New York City central offices, with an additional 27 currently under construction.

New local carriers generated more than 300 million inbound/outbound minutes of local calls in a recent month in the greater New York metropolitan area, and that number is growing at more than 10% per month.

*Question 7.* Mr. Young and Mr. Ellis, I am told that some Bell companies have negotiated discounts of well over 50% to resell long distance service. Have your companies obtained steep discounts in purchasing long distance for resale, and if so, was it advantageous to be able to negotiate with more than one company?

Answer 7. Bell Atlantic has an agreement with Sprint to resell Sprint's long distance service. Under that agreement, Bell Atlantic is not at liberty to disclose the price it pays for the Sprint service without Sprint's prior written consent, but I believe that the price we got is competitive with the price that Sprint gives to other customers. One of the benefits of a competitive market is that buyers have a choice of sellers and can negotiate with them to get the best possible deal.

Mr. Ebbers, I am also interested in your views on this subject.

*Question 8.* Mr. Ellis, you state in your written testimony that basic rates for long distance service have risen, but the long distance companies assert that long distance prices have dropped by more than half. Can you reconcile these contrary claims? Do discount packages and analysis of different time periods account for the full difference?

Answer 8. Not applicable.

*Question 9.* Mr. Young and Mr. Ellis, do you see your mergers as having any competitive impact on the ability of equipment manufacturers to sell to your companies in the future? Do you see your mergers as diverting management or capital resources and slowing investment in infrasture improvements?

Answer 9. I do not foresee that our merger will have any effect on the ability of equipment manufacturers to sell to Bell Atlantic.

In order to compete in the market that the Telecommunications Act has produced, Bell Atlantic must offer new services and improve the ones that it now offers. Improving our infrastructure is one of ways that we can do this. Management will be

focused on these efforts and will be expending capital resources whether or not the merger takes place.

*Question 10.* When the CEOs of Bell Atlantic NYNEX came to my office to discuss the need for their merger, they stressed that the combined company would be only a fraction of the size of the German and Japanese telephone companies. Could you each please give your perspective on competition with foreign companies, the likelihood of foreign competitors offering local exchange service in this country, and the need for American companies to become larger in order to meet foreign competition?

Answer 10. The telecommunications marketplace is becoming increasingly international in scope and is dominated by giant corporations and alliances. Individual companies such as AT&T, Nippon Telephone and Telegraph and Deutsche Telekom are all larger than the merged company will be. Even after AT&T's divestiture, it will be twice as large as the new Bell Atlantic. These international giants are also teaming up into global alliances like the AT&T-lead World Partners, MCI's and British Telecom's Concert, and Global One of Sprint, France Telecom and Deutsche Telekom. These arrangements are not merely ephemeral alliances that will come and go. British Telecom has invested $4.3 billion in MCI in return for a 20 percent stake in the company, an ownership interest comparable to what France Telecom and Deutsche Telekom received in exchange for their $3.7 billion investment in Sprint. These foreign concerns, through their interests in MCI and Sprint, are actively entering local telecommunications markets. In order to remain competitive, American companies must come close to matching the scope, efficiency and buying power of these firms.

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RESPONSES OF JAMES R. YOUNG TO QUESTIONS FROM SENATOR LEAHY

*Question 1.* A draft released last month by the Vermont Department of Public Service, states that the NYNEX-Bell Atlantic merger is expected to reduce operating expenses for NYNEX by about 5 percent. A press release issued jointly by Bell Atlantic and NYNEX estimated approximately $600 million in annual, recurring expense savings by the third year following the merger. That $600 million in annual, recurring expense savings by the third year following the merger. That $600 million was said to consist of approximately $300 million from reduction of 3,000 corporate and administrative management positions.

*Question A.* Do you stand by those estimates?

*Question B.* In a recent filing before the Vermont regulatory authorities, NYNEX indicated the good news that "no union represented employee will be laid off as a result of the merger." On the other hand, NYNEX indicated that about 1,500 redundant management positions from within NYNEX will be eliminated. How many of these positions will be eliminated in Vermont?

*Question C.* From what specific sources do you expect cost savings resulting from the merger to arise if there will be no loss of union jobs and only minimal loss of management jobs?

*Question D.* Will these reduced operating expenses be passed along to Vermont ratepayers, and if so, how soon can Vermont ratepayers see these savings?

*Question E.* How much of those cost savings are related to the core local telephone businesses, as opposed to other businesses such as cellular and foreign ventures?

*Question F.* Will competitive pressures be sufficient to assure that consumers enjoy a reasonable share of those cost savings?

Answer A. Yes.

Answer B. We have not gotten far enough into our merger integration planning to be able to answer this question.

Answer C. First, I want to make it clear that we are not talking about firing 3,000 employees. What we are talking about is eliminating 3,000 positions, while finding other positions for many of the people now in those slots. This will make our existing operation more efficient and free up valuable human resources for jobs in growing segments of our business.

Moreover, we expect that the merged Bell Atlantic will be able to achieve a variety of other cost savings. For example, the combined companies should be able to qualify for larger volume discounts from suppliers.

Answer D. The cost savings associated with the elimination of the 1500 positions will be allocated to its Vermont operations according to the company's usual cost allocation procedures. The extent to which these cost savings are ultimately reflected in prices will depend on many factors, including the overall financial performance of the business, the competitive environment and competitive pressure on prices existing at the time.

The greater efficiencies that are accrued as a result of the proposed merger will assist the post-merger corporation in holding down cost pressures and in responding to competitive pressures. Competition, not regulation, will drive rates in the future.

Answer E. We are not far enough along in planning the post-merger organization to be able to answer in any detail. However, because our cellular companies merged some time ago and because our foreign enterprises are relatively small, we would expect that most of the savings would come in the telephone exchange, toll and related areas of the business.

Answer F. Yes.

*Question 2.* Some press reports have suggested the job cuts resulting from the NYNEX-Bell Atlantic merger are being understated. Bell Atlantic has fewer workers per access line than NYNEX. Apparently, NYNEX would have to lose about 10,000 jobs to get down to Bell Atlantic's worker to line ratio. Do you anticipate efforts in a merged company to reduce NYNEX's worker to line ratio? If so, would that mean any job losses in Vermont?

Answer 2. We do not have any plans of this sort. However, the merged company, just like the two companies if they do not merge, will continue to strive to become more efficient in ways that will make it more competitive in the marketplace.

*Question 3.* In the early 1990's NYNEX in Vermont went through a period of downsizing its workforce. This trend seems to have turned around this year and I, obviously, would like to see this growth trend continue. What effect do you anticipate the merger will have, if any, on continuing job growth with NYNEX in Vermont?

Answer 3. Over the long term, I expect that the merged company's workforce in Vermont will grow as the company expands its offerings to its Vermont customers. The merged company will flourish in the global marketplace, and our employee base will grow as well.

*Question 4.* In your testimony, you indicated Bell Atlantic's "intent to fulfill the promise of the Act by bringing competition to the domestic long-distance market." By merging with NYNEX, Bell Atlantic has delayed its ability to offer long-distance in the current NYNEX region.

*Question A.* Will the mergers in fact delay your entering the long-distance market in the new combined regions?

*Question B.* How will the merger help Bell Atlantic and NYNEX better compete in the long distance market?

Answers A and B. Both Bell Atlantic and NYNEX are each working hard to comply with the Telecommunications Act's competitive checklist, and we expect to be ready to file applications to enter the interLATA business in our states early next year.

The domestic long distance market today is dominated by the Big Three carriers, AT&T, MCI and Sprint. Even after its divestiture, AT&T will be twice the size of the merged Bell Atlantic-NYNEX combination. MCI and Sprint are partly owned and funded by foreign telecommunications giants, British Telecom, France Telecom and Deutsche Telekom. We will need all the human and technical resources of the new Bell Atlantic to compete with these firms.

*Question 5.* Bell Atlantic and NYNEX reportedly plan to resell Sprint long-distance service outside their collective territories.

*Question A.* Is this report correct?

*Question B.* When do you expect to reach agreement with Sprint?

*Question C.* When do you expect to begin offering long-distance service over the Sprint network?

*Question D.* How does the NYNEX-Bell Atlantic merger affect the agreement with Sprint?

Answers A, B, and C. Both Bell Atlantic and NYNEX individually entered into contracts with Sprint that allow them to resell Sprint long distance service. Bell Atlantic has been authorized to provide long distance service in Michigan, Texas, North Carolina, South Carolina, Illinois, Ohio, Oregon, Florida, Iowa, Montana, Tennessee, and Utah, while NYNEX has been authorized in California, Colorado, Florida, Hawaii, Idaho, Indiana, Iowa, Illinois, Kentucky, Michigan, Montana, Nebraska, North Dakota, Oregon, Texas, Washington, Wisconsin and Wyoming.

Answer D. The terms of these arrangements are confidential, and Bell Atlantic cannot disclose them without Sprint's prior written approval.

*Question 6.* Vermont has not yet adopted price cap regulation, but has a proceeding ongoing to consider doing so. To ensure that ratepayers enjoy the benefits of cost savings from the mergers, should regulators insist that those savings be passed along to ratepayers, particularly in those States with price cap regulation? If not, could you explain why?

Answer 6. Price regulation establishes incentives for companies to be more efficient, while protecting customers against price increases to basic services. As such, under price caps, the company would not expect to seek a rate increase for transition and integration costs associated with the merger, nor would it expect rate decreases expressly to account for potential future benefits from the merger. Ultimately, it will be the market that will pass on any savings that the company achieves.

*Question 7.* Bell Atlantic has announced plans to "rebalance" rates in Pennsylvania, despite the rate freeze that Bell Atlantic agreed to there just a few years ago. The result of the rate change that Bell Atlantic is proposing would lower urban and suburban rates while raise rates in rural areas.

*Question A.* If the merger with NYNEX goes through, will you urge a similar "rebalancing" of rates in the rest of the combined Bell Atlantic-NYNEX region?

*Question B.* In the event Bell Atlantic's proposed "rebalancing plan" is adopted in Pennsylvania, how much do you estimate the rates in rural areas will rise?

*Question C.* If the same "rebalancing plan" proposed by Bell Atlantic in Pennsylvania were proposed for Vermont using the same criteria for urban, suburban and rural areas, how would telephone rates be affected in each area?

Answers A, B, and C. Under existing tariffs in Pennsylvania, Bell Atlantic residence service customers in rural areas pay less for basic telephone service than customers in Philadelphia and Pittsburgh, even though the cost to provide that service is higher in rural areas. Although the proposed rate rebalancing plan would raise rural customers' raters, these consumers would still pay less than customers in the big cities.

We have no plans to propose similar rebalancing in Vermont. There are discussions underway with the Vermont Department of Public Service to develop a price cap proposal that we would expect to last for the next few years. There are no plans or proposals for geographic deaveraging of rates in those discussions. No estimates exist that apply the Pennsylvania proposal to rates in Vermont.

*Question 8.* Will the Bell Atlantic-NYNEX merger affect the timing of the NYNEX offering video programming in Vermont and, if so, how?

Answer 8. There are at present no specific plans for offering video programming in Vermont. To the extent that the new Bell Atlantic believes there is a market opportunity for video programming in Vermont and that the Vermont market justifies the significant investments required for that business, then it is possible that the merger could facilitate its introduction.

*Question 9.* I understand that NYNEX and Bell Atlantic have no fewer than 25 different "Joint Merger Teams" focused on how to meld the companies together. At the same time, potential new entrants in the local market need the attention of these two companies focused on satisfying contractual and regulatory requirements on interconnection and unbundling.

*Question A.* What assurance can you give that the merger will not interfere in any way with complying with these new requirements?

*Question B.* If a potential new entrant ordered 10,000 local loops tomorrow, how long would it take NYNEX or Bell Atlantic to fill the order?

Answer A. We must comply with these new requirements if we are to get into the interLATA business in our territory. This, without more, will ensure our speedy compliance. Moreover, interconnection negotiations and arbitrations are governed by strict schedules prescribed in the Telecommunications Act, which ensure that issues will be resolved in a timely fashion.

Answer B. A local loop is a facility dedicated to an individual customer that runs from the telephone company office to the customer's location. I have a loop running to my home, separate from the two going to my next door neighbor and the 15 to the school across the street. A new entrant will not order an unbundled loop to an existing subscriber unless it has made a sale to the customer at the end of the loop.

The time it will take to provide an unbundled loop, or a number of unbundled loops, will depend on the complexity of the request—for example, whether the 10,000 loops represent a single large customer in a single central office or are scattered throughout multiple central offices, and whether additional steps, such as conditioning, must be taken to provide loops with the capabilities requested by the new entrant. For this reason, it is not possible to give a single, answer to the question. Bell Atlantic and NYNEX will negotiate the installation intervals for unbundled loops with the new entrant based on the complexity of the request, and if no agreement can be reached, then arbitrators in each State will make determinations consistent with the Telecommunications Act.

*Question 10.* Some analysts have urged that the mergers between Regional Bell Operating Companies be approved only after the companies have met the "competitive checklist" contained in the Telecommunications Act of 1996 for each of the states in which they operate today. This would not guarantee but would certainly

help assure that resources continue to be directed first to opening up the local loop and then to the merger.

*Question A.* Since both NYNEX and Bell Atlantic presumably intend to comply with the competitive checklist, what objection, if any, do the companies have to this proposal?

*Question B.* If the Bell Companies were required to meet the "competitive checklist" before the pending mergers are approved, would the timing of the mergers be delayed? If so, for how long do you estimate the mergers would be delayed?

Answers A and B. The proposal is completely illogical and unnecessary.

First, the competitive checklist of section 271 of the Communications Act is part of the test for Bell company entry into the interLATA business in the areas in which they currently provide local exchange service. It has nothing to do with a Bell company's entry into the local exchange business in a different area, whether by merging with the incumbent or otherwise. The antitrust laws prescribe the standard for preventing this merger—whether it will substantially lessen competition in some line of commerce.

Second, companies like Bell Atlantic and NYNEX already have a powerful incentive to comply with the competitive checklist because they cannot get into the long distance business until they do so.

At this point, we expect to be in compliance with the checklist early next year. Although harder to predict, we also expect to receive the regulatory approvals we need for the merger in that same time period.

*Question 11.* Consumers want to know what this merger will mean for their quality of service, things like repair intervals, customer trouble reports and missed service appointments. On this score, NYNEX has been required to pay $4.1 million in rebates to customers in New York because of poor service quality. The New York Public Service Commission found that service quality was worse on every level compared to the prior year. Competition forces rivals to provide better service. With the merger, NYNEX customers will be denied the opportunity for improved service that would follow if Bell Atlantic had entered as a competitor instead of as a new owner. How will the merger with Bell Atlantic give NYNEX customers in New York, as well as Vermont, better service than if Bell Atlantic had entered the local phone service market as a competitor?

Answer 11. Bell Atlantic is neither an actual or potential competitor for local telephone service in Vermont. Bell Atlantic has no network facilities in Vermont with which to supply services. There are other telecommunications firms that already have network facilities, customers and brand recognition in Vermont, and these firms are much more likely to enter the Vermont telecommunications market than in Bell Atlantic, NYNEX and Bell Atlantic believe that customer service will be improved in Vermont and elsewhere under the new Bell Atlantic. The merged company will unite the skills, talents and know-how of researchers, network engineers, managers and other employees now working separately in each of the two merging companies. Each company's "best practices" will be transferred to the other and benefit the customers of both.

*Question 12.* Bigness seems to be a major justification for the Bell Company mergers. Both NYNEX and Bell Atlantic have said that being bigger will allow them to exploit economies. Taken to its logical extreme, if bigger is better, a combination of all the Bell Companies would be even better. What is it about these two particular companies that make their merger in the public interest of Vermont and the other States in the combined region?

Answer 12. This merger combines two corporations that currently serve two adjacent, but distinct, parts of the northeast corridor from Maine to Virginia. The combined territory is one of the most communications-intensive regions in the world, and one of the most competitive. The merger will create a company better able to compete with companies like AT&T and MCI, with lower unit costs and greater efficiencies.

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RESPONSES OF JAMES R. YOUNG TO QUESTIONS FROM SENATOR FEINGOLD

*Question 1.* Obviously, Bell Atlantic/NYNEX would not be merging if there were not sufficient cost efficiencies to be gained. I saw in your press materials at the time of the merger announcement that the Bell Atlantic/NYNEX merger will result in cash savings of $900 million a year.

*Question A.* How much of the expected $900 million in cash savings do you expect to pass on to consumers? Please provide estimates as to how much consumer prices will come down relative to current levels as a result of these mergers.

*Question B.* How specifically will those cost savings be passed down to consumers in your service region? Please provide a time line for the projected price reductions and identify the lines of service for which you expect the greatest price reduction.

Answers A and B. Competition is the best tool to ensure that consumers benefit from efficiencies and cost savings. As local telephone companies like those owned by Bell Atlantic and NYNEX are freed from the restrictions of rate regulation by the states and the FCC, they will have the flexibility to be more price competitive and have the ability to pass these and other savings on to their customers.

*Question 2.* Some of the biggest concerns for new entrants into local service include both the terms of the interconnection agreement as well as the quality of the service provided to the entrant for the network elements they are reselling. I know that some of the new entrants to local markets and some of your existing competitors are very concerned about both the ability and the willingness of the RBOCs to properly provide service, maintenance and interconnection during the merger transition period.

*Question A.* What assurances can you provide customers and competitors that the quality of your service will not be affected during the merger transition period?

*Question B.* If you believe service to those businesses with which you have interconnection agreements will not be affected by the merger, why do you oppose tying approval of the merger to a requirement that service to those competitors be no worse than prior to the merger as suggested by Mr. Atkinson from Teleport?

Answers A and B. Telephone companies like those affiliated with Bell Atlantic and NYNEX are already under strict non-discrimination obligations, which assure that the quality of service they provide to Teleport is at least as high as those companies provide to themselves and their own customers. However, nothing in the Communications Act requires or authorizes what Teleport has asked for—the establishment of mandatory service performance standards and penalties for failures to meet such standards—and the FCC has declined to do so.

Bell Atlantic has committed to provide service to Teleport at levels that meet or exceed Bell Atlantic's average network performance levels and to provide Teleport with performance reports generated in the ordinary course of business. As long as Teleport, or any other competitor, receives service that is comparable to that which Bell Atlantic provides to itself and its customers, the interests of a fair competitive marketplace are satisfied.

Since the date of the hearing, Bell Atlantic has voluntarily reached agreement with Teleport on a set of quality and performance measurements that Bell Atlantic will provide to allow Teleport to determine whether the service Bell Atlantic provides Teleport is on parity with the service Bell Atlantic provides to itself and others.

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RESPONSE OF JAMES D. ELLIS TO QUESTION FROM SENATE COMMITTEE ON THE JUDICIARY

SBC COMMUNICATIONS INC.,
*September 18, 1996.*

Hon. PATRICK J. LEAHY,
*U.S. Senate,*
*Washington, DC.*

DEAR SENATOR LEAHY: On September 11, 1996, I testified at a hearing before the Senate Judiciary Committee on "Mergers and Competition in the Telecommunications Industry." During that hearing, you asked a series of questions concerning the issue of Bell companies competing with one another. Your inquiry focused on the issue of whether or not the Bell companies intended to compete with one another in the local exchange marketplace. In response to your questions, a difference of opinion arose between Bernard J. Ebbers, President and Chief Executive Officer of LDDS WorldCom and me over the facts on this issue. You invited us to supplement the record in order to correct this discrepancy.

BACKGROUND

During the hearing, you observed that number of long distance companies and local access providers have sought interconnection with the incumbent Bell companies to bring some competition to the local exchange. You suggested that the Bell companies can do the same thing, but have not. You paraphrased and quoted, in part, from Mr. Ebbers' written testimony which stated that despite their expertise in the provision of local phone service, "not one of the Bell's applications to offer service in an out of region state requests certification as a local carrier." *See* Written

Testimony of Bernard J. Ebbers at p. 2. You then asked Mr. Ebbers if that was a "fair" reading of his written testimony. Mr. Ebbers acknowledged that your characterization of his written testimony was "fair." You then asked if it was correct that no Bell company has filed to provide service as a local carrier outside their own service territory. I responded that this was not correct, and indicated that SBC had filed in Illinois and New York. Mr. Ebbers disagreed with me, and stated that SBC had really filed to be a long-distance carrier in those states. I reaffirmed that SBC had filed to obtain a certificate to provide local exchange telephone service in Illinois and New York, and went on to describe SBC's strategic plan to compete out-of-region where it has network facilities, brand name recognition, and a customer base.

THE FACTS

SBC, through its subsidiaries, has filed applications for and has obtained certificates of authority to provide *both* local exchange and interexchange services in Illinois and New York.

In Illinois, SBMS Illinois Services, Inc., an indirectly wholly owned subsidiary of SBC, was granted a Certificate Of Interexchange Service Authority "to provide interexchange telecommunications services within MSA–1," a Certificate of Service Authority "to provide and resell local exchange and intraMSA interexchange telecommunications services in those portions of MSA–1, served by Illinois Bell Telephone Company and Central Telephone Company," and a Certificate Of Exchange Service Authority "to provide facilities-based exchange telecommunications services in those portions of MSA–1 served by Illinois Bell Telephone Company and Central Telephone Company" on December 20, 1995. (Emphasis added.) A copy of the *Order* from the Illinois Commerce Commission granting SBC this authority is attached hereto.

In New York, SBMS New York Services, Inc., also an indirectly wholly owned subsidiary of SBC, was granted a Certificate Of Public Convenience and Necessity "to provide point-to-point, switched and non-switched intercity and intracity telecommunications service and to resell all forms of telephone service in the State of New York" on October 25, 1995. (Emphasis added.) The order granting this certificate noted that SBMS New York Services, Inc. petitioned to provide "residential and business local exchange service." A copy of the Order Issuing Certificate Of Public Convenience and Necessity from the New York Public Service Commission granting SBC this authority is attached hereto.

If you or any members of the Committee have any further questions concerning this issue, or any other matter raised during the hearing, please do not hesitate to contact me.

Respectfully yours,

J.D. ELLIS.

[EDITOR'S NOTE: The above mentioned attachments are located in Committee files.]

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RESPONSES OF LDDS WORLDCOM TO SENATORS' QUESTIONS

*Question 1.* I understand that the most lucrative segments of the local exchange market are the urban and commercial markets. What percentage of your local exchange revenue do you anticipate getting from these markets?

Answer 1. While the term "most lucrative" can mean the most profitable, we understand the question to mean the services with the highest comparative prices, when viewed against residential service. It must be remembered that that rate structure was developed between the incumbent local exchange carrier and Public Service Commission through proceedings designed to subsidize basic local residential rates. The practice of charging higher rates to commercial customers for essentially the same service was developed as a by product of the expansion of the availability of telecommunications service throughout the United States. The Bell System started in major metropolitan area, city to city, and added residential service along the way. LDDS WorldCom will commence entry into the local exchange market in the same way that ILECs did over the past one hundred years: provide service to commercial customers to support build out and investment, add residential service as the network will allow.

The issue is not strictly an urban, suburban issue. WorldCom's entry strategy into the long distance market was to serve customers in urban and rural areas. While local service network build out logically might occur in business areas, today the term business area includes commercial investment that is being made in what was once considered a rural area.

If the term "most lucrative" was meant to address the most profitable segment of local service, the predicate for the question is plainly wrong. The most profitable segments of the local exchange market would be the ancillary services, e.g., CLASS and Caller ID services, that are offered primarily to residential customers.

With that said, over the short term WorldCom expects to obtain over 95% of its local revenues from commercial markets. There are other carriers that have indicated they will be entering to serve residential markets at the outset, e.g., AT&T, MCI, TCG, and others. Moreover, service will continue to be available form the incumbent local exchange carrier. Note, however, that WorldCom includes in its definition of commercial markets the carrier customers that do provide service to residential customers. Accordingly, WorldCom's network is being used to provide residential services.

*Question 2.* You have testified that your company relies on the Bells' existing networks in the local exchange markets. Is this true even where MFS already has an existing network? Could you explain why?

Answer 2. As the question implies the answer is yes.

Local service entry on a facilities basis is a building-by-building connection process. In order to serve customers that are not presently connected to the MFS network, at a minimum, we will have to rely upon the facilities of the incumbent carrier for connection to the customer premises. In certain areas customers may have diverse office locations, including home offices or telecommuting facilities. In one area we may have facilities, in others we may not. The customer may want service from one provider for all services at all locations. Without using the incumbent local exchange carrier, including the Bell Operating Companies, we would be foreclosed from the market.

*Question 3.* How much of an advantage do you think an incumbent local exchange provider would have in the long distance market due to customer loyalty and/or preference for so called-one stop shopping?

Answer 3. The question is hard to answer because different customer types have different perceptions and incentives to adopt one stop shopping, and may or may not have customer loyalty. For example, one incumbent local exchange carrier may have a great relationship with its customers, other may have the monopolist tag that has created a ground swell to leave that carrier.

The advantage the incumbent local provider has it is primarily focused on the fact that the customer has never tried a different local phone company. Therefore, anyone competing with the incumbent must provide service equal to or better than the incumbent. By contrast, many customers are already comfortable about switching long distance carriers. They are aware that it does not affect the quality of their essential local service. Note that almost every single IXCs customer obtains local service from the incumbent. For the most part, the customer is satisfied with the local service and is dealing with a known entity. Local service more than long distance service is a critical service to the end user. If long distance service is disrupted on one carrier's network, customers either know, or are advised as to, how to dial another carrier's network to handle calls during the outage. Customers view local service differently. So the advantage goes to the incumbent at the outset.

Preference for one-stop shopping is a function of what services will be included in the package of services. LEC addition of long distance service, as a technical matter, is just an extension of their existing intraLATA long distance services. The ILEC presently has the full array of local services. It just needs to add the phrase long distance and international services to its advertising and collateral sales material. The story the other way is much different.

Facilities-based competitive local exchange carriers appear to be in a similar position to the ILEC for the customers they are able to serve over their own facilities. However, where they must rely upon the incumbent LEC for underlying service, they are at the mercy of the incumbent's pricing practices for services made available for resale, or, if they are using unbundled elements, the features and functions that are included with the unbundled element and the administrative processing procedure to obtain them. Few incumbent LECs have demonstrated a desire to meet on the competitor's terms the needs of the competitors in provisioning the wholesale products. The combination of control over the service, its prices and provisioning distinguishes the Incumbent LEC advantage from the IXC advantage.

Don't you think it works both ways—that is, wouldn't an incumbent long distance provider have an advantage in the local market due to customer loyalty and/or preference for one-stop shopping?

No, see above.

*Question 4.* Sen. Feingold: MFS and WorldCom have had to rely on the RBOCs for at least some degree of interconnection to achieve the market penetration you currently enjoy. What concerns do you have in terms of MFS's interconnection

agreements with the BOCs with respect to the merger of SBC/PacTel and Bell Atlantic/NYNEX?

Answer 4. The primary concern is in the implementation of the interconnection agreements. In a traditional marketplace client/vendor relationship, the vendor is seeking to accommodate the client's desires as to service quality and delivery timetable. The shifting regulatory/legal sands in our industry, coupled with an incumbent's absence of desire to provide the wholesale service or interconnection in the first place, gives the RBOCs the ability to waffle and twist and turn on each issue. There is no wholesale competitor to which a BOC risks losing material portions of this new business over the next several years. By merging with a powerful potential competitor, the incumbent retains its position in these markets, and the potential competitor has gained the incumbent's advantage in the new territory. Both incumbent's revenues are protected in the merger process. While the competitive entrants now face a stronger, more formidable opponent.

*Question 5.* Sen. Thurmond: Mr. Ebbers, to what extent do you consider the merger between WorldCom and MFS to be "defensive" or compelled by changes such as the Bell mergers? Do you think that larger telecommunications companies will enhance competition and create greater efficiencies for the benefit of consumers?

Answer 5. Size will enable carriers to generate resources to provide additional services and employ more advanced technology, that should lead to consumer benefit. Is there a point where size becomes a non-factor, or can a carrier reach a point of being so big that being bigger has little or no meaning? Can carriers be of such size that they can act without fear in trampling out competition? Probably, but it is not an issue for a company with less than a 5% market share.

The WorldCom/MFS merger is an offensive move to take advantage of the market opportunities presented by the changing environment and retain customer base, while attempting to achieve the capabilities of carriers such as Bell Atlantic/NYNEX and SBC/PacTel. The merger is driven by many factors in the marketplace: the changing regulatory environment, the ability to provide a combination of services, the need to rely upon the monopolist competitors facilities, the reluctance of the incumbents to give carriers what was being requested, etc.

*Question 6.* Mr. Ebbers, do you expect MFS ever to begin offering service to residential customers, rather than simply to business customers? How do you respond to assertions that targeting big customers first is "cream skimming"?

Answer 6. WorldCom would direct the questioner to the first response. We're not sure what "cream skimming" means.

Does it mean that MFS WorldCom will introduce services that are only high margin services? As noted that is where the Bell's focus today. The advertising for their services that I'm aware of is targeted to those services that have margins in the range of hundreds and thousands of percent.

Does it mean that MFS WorldCom will confine its service areas to the service areas that are most populated? We probably will, but isn't that what the Bells do today? Isn't that why we have so many independent telcos, because the Bell companies didn't want to serve those areas?

Does it mean that by first addressing the business community MFS WorldCom will be able to generate sufficient funds to deploy its network to serve all types of customers that its facilities pass? Isn't that how the Bell's did it? (Not to mention MCI and Sprint.) And, given the costs involved, even after those substantial Bell resources were deployed they couldn't handle the expansion to more remote areas. The regulators had to contribute to the effort through the use of universal service funds and other subsidies.

Does it mean that MFS WorldCom will enter the market in a manner that good business judgment dictates? Then the answer is we will, just as the Bell System did.

*Question 7.* Mr. Young and Mr. Ellis, I am told that some Bell companies have negotiated discounts of well over 50% to resell long distance service. Have your companies obtained steep discounts in purchasing long distance for resale, and if so, was it advantageous to be able to negotiate with more than one company?

Answer 7. Mr. Ebbers, I am also interested in your views on this subject.

From WorldCom's point of view, the Bell companies were such good prospects that the IXC wholesale carriers sought to offer attractive prices that would win their business. That is a competitive environment. The effectiveness of the ability to negotiate in a competitive environment is demonstrated by (1) the BOCs ability to demand the terms, including rates, under which the services were to be provided, (2) the discounts achieved, and (3) the willingness of the carrier to accommodate the BOCs desire. Those wholesale carriers wanted the BOCs business. The BOCs ability to address common objectives and combine together in negotiations further enhanced their negotiating posture. The market incentive are not the same when entrants are negotiating with an entrenched monopolist.

RESPONSES OF ROBERT C. ATKINSON TO QUESTIONS FROM SENATOR HATCH

*Question 1.* Can you tell me exactly why you believe that the Bell mergers will make competitive access providers more dependent on Bell service?

Answer 1. The concern I expressed in the hearing is that an RBOC merger may cause the quality of the competitive interconnections provided by the resulting "Big Bell" to deteriorate, at least in the near-term. Competitive local exchange carriers (CLECs) depend on these interconnections (i.e., unbundled loops, completion of calls to the Big Bell's subscribers) to provide their competitive services. Therefore, a deterioration of the Big Bell's interconnection quality immediately impairs the quality of the CLEC's customers, who hold the CLEC accountable for the total quality of the service.

However, I do not believe that a merger changes CLECs' dependency on Bell services. For the foreseeable future, every competitive local carrier will be dependent on the facilities and services of the incumbent local exchange carrier (ILEC), whether the ILEC is a small "independent" telephone company, a giant GTE "independent," a current RBOC, or a "Big Bell" resulting from an RBOC merger.

*Question 2.* As you recognized, section 251 of the Telecommunications Act already requires incumbent local exchange carriers to provide interconnection at least equal in quality to that provided by the local exchange carrier itself. I think Congress has already expressed its intent with regard to interconnection performance standards. Is it consistent with this intent for additional performance standards to be imposed through a consent decree?

Answer 2. Yes.

TCG's proposal is simply that, at a minimum, a consent decree condition must require the "Big Bell" to maintain the status quo with respect to the quality of interconnection with competitors. In my opinion, maintaining the status quo is not an "additional" performance standard and, more importantly, such a condition would be fully consistent with Congressional intent that Sec. 251(c) establish critical competitive safeguards.

In particular, I believe that Congress intended Sec. 251(c)(2)(C) to be a competitive safeguard to protect competitors, who are utterly dependent on interconnection with the ILEC, from a number of anticompetitive abuses which have characterized "interconnection" since the earliest days of the telephone industry. I also believe that Congress expected ILEC performance to generally increase as a result of new technology and the prospect of competition so that Congress expected that Sec. 251(c)(2)(C), as a competitive safeguard, would provide CLECs with a flexible, evolving and improving standard of interconnection quality.[1] By contrast, since tying a competitor to a deteriorating quality of interconnection would not be an effective competitive safequard, I doubt that Congress intended that a competitive safeguard could have this perverse result.

My conclusion, therefore, is that Congress expected interconnection quality to be generally improving and not deteriorating and enacted Sec. 251(c)(2)(C) with this expectation in mind. A consent decree condition that merely requires the status quo would be perfectly consistent with such Congressional expectation and intent. Indeed, a consent decree condition that required steady improvement of the ILEC's interconnection quality would also be consistent with this Congressional expectations and I would hope that the Department of Justice would seek such a more stringent and pro-competitive condition.

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RESPONSES OF ROBERT C. ATKINSON TO QUESTIONS FROM SENATOR THURMOND

*Question 1.* As I indicated in my opening statement, I am interested in your views about how competition in local exchange and long distance services may develop over the next few years, and particularly your estimates of the number of likely competitors with substantial shares of those markets. Would each of you please comment.

THE CLEC INDUSTRY CURRENTLY

Answer 1. I have attached to this response a report entitled "Local Telecommunications Market Shares" published in July 1996 by New Paradigm Resources Group. New Paradigm and a predecessor research organization have been following the de-

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[1] I suppose that one could argue that Sec. 251(c)(2)(C) fixes the quality standard at the level which existed as of the date of enactment. If this were thee case, I would agree that a consent decree condition requiring the status quo would not be necessary.

velopment of the competitive local telecommunications industry for a number of years. New Paradigm's conclusion (pp 10–11) is:

"While CLECs continue to grow at healthy rates, the total telecommunications market also continues its upward growth. Therefore, CLEC market share has not increased enough so that an argument can be made that meaningful competition exists. * * * Market share, in this instance, can be used as an indicator of the 'fragility' of the nascent competition.

"CLEC market share has increased for all component of the local telecommunications market, but it still remains minuscule when compared to the revenues and market shares of the RHCs."

The report demonstrates that CLECs had the following revenues and shares of the sectors of the local telecommunications market in 1995.

| | $ Million | Share (%) |
|---|---|---|
| Local exchange service | 177 | 0.4 |
| Dedicated access | 540 | 10.6 |
| Switched access | 76 | 0.28 |
| IntraLATA Toll | 264 | 1.8 |

With respect to the above table, I would observe that it took the CAP/CLEC industry 10 years to collectively achieve the 10.6 percent share of the "dedicated access" market sector.

TELEPORT COMMUNICATIONS GROUP CURRENTLY

I believe that Teleport Communications Group (TCG) is the nation's largest facilities-based competitive local exchange carrier (CLEC). Our nationwide revenues (all from local telecommunications services) for the first six months of 1996 were approximately $123 million and it is estimated that the "local telecommunications" market was about $50 billion for the same six months. On a revenue basis, therefore, TCG's share of market was about 0.25 percent. From this, it is fair to say that effective local exchange competition does not exist nationally.

THE FUTURE

Wall Street analysts have projected that TCG's local exchange service revenues will grow at a compound rate of 40–50 percent over the next ten years (to the year 2005), resulting in annual revenues in the range of $3.5 to $4.0 billion.

These analysts also project that the entire local exchange market will be worth $145–150 billion by 2005, implying that TCG's share of the revenue will be in the range of only 2.3–2.7 percent. The implication is that TCG will not have a "substantial" share of the local exchange market (i.e., in excess of 10 percent), even after growing 40–50 percent for ten years.

Will other carriers be able to capture a "significant" share of the local exchange market?

The legislative history of the Telecommunications Act reflects an expectation by the Congress that the cable television industry may become a significant competitor of the ILECs because the cable companies have extensive, ubiquitous facilities that pass an estimated 90 percent of the homes in this country. Cable television companies have significant ownership interests in TCG and TCG is working with some cable television companies to trail the technologies that will be required to make cable television systems capable of carrying basic telephone calls. I am optimistic that these trials will be successful and that the cable television systems will be transformed, over time, into systems that are capable of competing with the ILEC networks. However, because this transformation will take considerable time and considerable investment, I doubt that any facilities-based competitor will have captured a "significant" share of the market (i.e., more than 10 percent) by the turn of the century.

However, some carriers may have a substantial revenue stream from the resale of ILECs services. But, as I mentioned in the hearing, "resale" of ILECs services does not constitute the kind of competition that provides consumers with a safeguard against monopolistic abuses. Indeed, "resellers" are effectively sales agents of the ILECs, not competitors.

My ultimate conclusion is that a majority of business customers and most residential consumers will not have an effective choice of facilities-based local exchange carriers for the rest of this century.

*Question 2.* Mr. Salsbury and Mr. Atkinson, what percentage of the local exchange market do your companies expect to achieve in the future? What are your projections for the next three to five years?

Answer 2. Please see my response to question one, above.

*Question 3.* Mr. Atkinson, you indicated in your written testimony that Teleport is the Nation's leading competitive local exchange carrier. How do your local exchange service revenues compare to the local exchange revenues of the Bell companies or GTE?

Answer 3. As explained in my response to question one, above, I estimate that TCG currently has approximately a 0.25 percent share of the total local telecommunications market.

*Question 4.* Please state your view of the assertion that, despite their dominant position, the Bell companies are not fierce competitors in the marketplace because they have grown complacent from years of regulation.

Answer 4. I totally disagree with this assertion because the Bell companies aren't really regulated and they aren't complacent.

Today, most of TCG's retail (non-carrier) revenues come from "large business" organizations. This "large business" sector of the local telecommunications market has been virtually deregulated in most States for many years. For example, most States have deregulated private line, Centrex and PBX services or allow ILECs to file "Individual Case Basis" tariffs that are customized for each customer and are not cost-justified. Where they have been deregulated, the ILECs are generally aggressive competitors, particularly with respect to prices.

Of course, since the vast majority of the ILECs revenues are NOT currently subject to any competitive threats, the ILECs' aggressive pricing in the small "competitive" niches is financed by over-pricing—with "regulatory" acquiescence—the monopolized services and over-charging captive consumers.

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RESPONSES OF ROBERT C. ATKINSON TO QUESTIONS FROM SENATOR FEINGOLD

*Question 1.* Some competitive local exchange carriers have suggested that it is very difficult to achieve resolution with FCC and state regulators of performance and service complaints on interconnection agreements. What system would you establish to address resolution of service and performance complaints?

Answer 1. TCG is particularly concerned about the inability of traditionally regulatory process to address and resolve performance and service quality problems associated with CLEC–ILEC interconnection. This concern is based on years of actual, real-world experience of being interconnected with ILECs, getting mediocre to awful performance from the ILEC and being unable to obtain any timely, effective relief from the FCC or State PUCs.

The chief reason that the regulators have been unable to resolve the performance and service problems in a timely fashion is that the ILECs are masters at "gaming" the regulatory process.

Sec. 251(c)(2)(C) of the Telecommunications Act requires ILECs to provide interconnection which is at least equal in quality to the interconnection that they provide to themselves, affiliates and other carriers. This requirement implies some sort of regular quality reporting by the ILECs since this duty would be meaningless and unenforceable without comparative data. Assuming that comparative quality data is regularly available, CLECs would be able to seek damages and possibly injunctive relief based on "unequal" quality.

In some interconnections negotiations with some RBOCs, TCG has obtained agreement on "liquidated damages" so that TCG would obtain some immediate compensation in the event of a serious performance failure by the RBOC. Such liquidated damages avoid the expensive and time consuming effort of seeking damages through regulatory or judicial process. To be effective, liquidated damages must be substantial so as to discourage wilful noncompliance.

In the absence of a liquidated damages agreement, TCG would recommend some sort of alternative dispute resolution (ADR) process to resolve quality and performance problems, rather than conventional regulatory proceedings.

*Question 2.* Mr. Barr, representing GTE, commented that one reason to be unconcerned about the proposed RBOC mergers is that the "local bottleneck has been opened up wide."

I know your company has interconnection agreements with a number of the RBOCs and is offering local service in a number of urban markets. I also understand that your company has also asked a number of states to arbitrate or mediate interconnection agreements. Would you comment on how wide open the bottleneck is based on your experience as a local service provider?

Answer 2. Mr. Barr's assertion is quite laughable.

There are two real "local bottlenecks" that constrain the development of effective local exchange competition, and neither are "wide open": the physical connection between consumers' premises and a CLEC's network (i.e., a "loop bottleneck"); and, the termination of traffic carried by a CLEC to an ILEC's customer (i.e., a "call completion bottleneck").

THE LOOP BOTTLENECK

With respect to the "loop bottleneck," CLECs such as TCG would prefer to NEVER rely on ILEC unbundled loops for this critical path because it is simply unacceptable to be so reliant on a powerful competitor that has a 100-year history of abusing its control of this essential facility. Unfortunately, CLECs are forced to rely on unbundled ILEC loops for a number of reasons.

One of the most pernicious reasons that CLECs are forced to rely on their ILEC competitors is landlord's discriminatory demands for outrageous payments from CLECs. In fact, some commercial and residential landlords simply refuse to allow CLECs to install their cables and equipment on their premises, making it physically impossible for the CLEC to have direct access to customers. In other cases, the landlords demand such high payments for allowing CLECs to access their tenants that the CLEC is economically prohibited from direct access. This problem is generally compounded by discrimination resulting from the ILEC's undue bargaining leverage based on their historic monopoly: ILECs rarely pay landlords to access their tenants because the ILECs refuse to provide service under such circumstances and landlords would find it impossible to rent their premises without basic telephone service.

Technological developments, such as telephony over cable television facilities and "wireless" loops may substantially reduce the "loop bottleneck" at some point in the future. But additional technological developments and substantial risk capital investments are necessary and the cost for the new technology must fall dramatically before they can be considered an operational and economic substitute for the ILEC's ubiquitous loop networks. Therefore, today and for the immediate near-term, there is no practical alternative to the ILEC loop for access to the vast majority of telephone consumers and the "loop bottleneck" continues.

It is also important to understand that the Telecommunications Act has had no practical impact on reducing the "loop bottleneck". The rates for unbundled loops and the collocation arrangements that are needed by CLECs to use unbundled loops are uncertain at best and generally too high. As a result of the 8th Circuit's Stay of the FCC's Interconnection Order, the uncertainty is likely to continue for the foreseeable future.

But even pricing unbundled loops "correctly" won't change the "loop bottleneck" substantially. The point of my testimony before the Committee was that ILEC performance in providing unbundled loops is equally, it not more, important than the simple price of the unbundled loop. This is because the cost to a CLEC—in terms of direct out-of-pocket cost as well as the substantial costs associated with establishing and maintaining a good reputation with customers—of a missed installation date of an unbundled loops or frequent service problems with an unbundled loop are almost incalculable. We have seen no substantial improvement in ILEC performance with respect to unbundled loops and, if anything, performance is deteriorating.

THE CALL COMPLETION BOTTLENECK

After a CLEC gets a customer on its network, it must be able to deliver that customer's call to any other telephone, particularly to the ILEC's subscribers. Unlike the "loop bottleneck", there is no foreseeable technological or other solution to the "call completion bottleneck": CLECs' will be permanently and unavoidably dependent on ILECs for call completion, forever. Congress recognized the unique and permanent nature of the "call completion bottleneck" when it established special pricing rules for "Transport and Termination". *See,* Sec. 252(d)(2). These pricing rules will result in Transport and Termination (i.e., call completion) being priced at the absolute lowest possible level of the "reasonable approximation of the additional costs" incurred by the ILEC to terminate the CLEC's traffic.

Contrary to Mr. Barr's assertion, the "call completion bottleneck" not only isn't "wide open", it probably never will be. Consequently, this bottleneck requires substantial and strong regulation, probably forever.

*Question 3.* One of the issues associated with these mergers, particularly with respect to the Bell Atlantic/NYNEX proposal, is whether the RBOCs with adjacent markets would have had a natural competitive advantage if they chose to compete with their neighbor. Consumer groups have suggested that as a result of some of the joint ventures, such as Bell Atlantic/NYNEX Mobile, the joint cellular business

operated by the two BOCs, name recognition would be high and competitive opportunities would exist.

In Mr. Barr's testimony, he suggested that neighboring LECs do not have a competitive advantage over other new entrants into local service.

As a competitor for local service, do you agree with that conclusion? Would MCI and TCG be concerned if, in one of their local service markets, the neighboring local exchange carrier chose to enter that market?

Answer 3. I disagree with Mr. Barr's conclusion.

One of the major costs associated with becoming an effective competitive local exchange carrier is "brand recognition". In major markets, brand-recognition advertising could cost tens of thousands (and possibly hundreds of thousands) of dollars per day, every day, for years. Mass media advertising isn't precise: radio, television and newspaper ads for one LEC are often viewed outside that carrier's actual service territory. This is particularly the case in the New York City metropolitan area: NYNEX's advertising is seen by many Bell Atlantic subscribers and vice versa. Similarly, in California, Texas, Washington State and Florida, GTE service territories about RBOC service areas and GTE and the RBOC each have "name recognition" outside their traditional service areas as the result of advertising to their traditional customers.

The "free" advertising and name recognition enjoyed by ILECs in areas adjacent to their traditional service areas gives them a substantial competitive advantage vis-a-vis "start up" CLECs when it comes to consumers selecting a CLEC. Of course, interexchange carriers that employ mass media marketing have the same name recognition advantage vis-a-vis "start up" CLECs as the adjacent ILECs.

[EDITOR'S NOTE: New Paradigm Resources Group, Inc.'s Research Report on: Competitive Telecommunication, dated July 1996, is located in committee files.]

**But Implementation Will Be Deviled By The Details**

Despite all indications that the major regulatory milestones will be met, businesses expecting an all-out competitive war soon thereafter will be disappointed. The technical details and process of tearing down the iron curtain surrounding the local monopoly will impede instant market opening.

- **Users will grow a beard waiting to switch carriers.** Local carrier switches cannot handle a boatload of orders for call forwarding arrangements -- the interim solution for number portability -- especially if those requests pile in monthly from firms with hundreds of lines. True number portability, in which phone numbers can be rehomed to any carrier, will require a massive overhaul of every carriers' signaling network and won't begin until 1998.

- **Endless glitches – like lost orders – will be really frustrating.** Ordering local service today kicks off a bevy of events, like feature setup, installation scheduling, and directory assistance listing. But when the responsibility is split between the incumbent and its competitor, botched intercompany communications and manual processes will snarl up even the simplest service requests.

- **Incumbents will appeal to the courts.** Eager to delay competition in their home regions, some local telcos will ask the court to overturn the FCC. While these challenges will get heard and slowdown the opening of markets, we believe they will not massively reverse the tidal wave of change already unleashed by Congress.

- **Competitors will resist cooperation.** Businesses that try to mix and match AT&T's Call Prompter with Bell Atlantic's Toll Free service will get "no" for an answer. Why? Neither player will want to share business with the other which The Act doesn't require. Advanced services like Web hosting, call center routing, and network management will remain off-limits for one-stop shopping.

- **Workers will stress out on the job.** Layoffs are already rippling through the telco ranks. More are sure to follow. Disgruntled employees will rebel against the shakeout by slowing down work orders, going on strike, or forcing politicians to erect new barriers by second-guessing regulators.

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**Figure 6**

*New Access Technologies*

| | Key facts | Availability and price |
|---|---|---|
| 38 Ghz microwave | ▪ Bypasses telco landline T1s<br>▪ Great for path diversity<br>▪ Limited by line-of-sight | ▪ Start-up vendors: ART, BizTel, WinStar<br>▪ About 20% less than landline T1s |
| Inverse multiplexing | ▪ Multiple T1s made into large chunks of contiguous bandwidth<br>▪ Speeds between 1.5 and 45 Mbps<br>▪ Needs matching equipment at customer and carrier sites | ▪ Leading equipment vendors: ADC Kentrox, Digital Link, Larse, Verilink<br>▪ Regular monthly cost for T1 plus $8,000 per box |
| ATM | ▪ Smashes voice, video, and data bits together for bandwidth economies<br>▪ Runs best at DS3 speed<br>▪ Expensive, complex, unproven | ▪ In early deployment by RBOCs, GTE, and competitors<br>▪ About 20% more than regular circuits |
| DSL | ▪ "Digital subscriber line" reuses existing copper wires<br>▪ 1.5 to 6 Mbps carrier service<br>▪ Many incompatible versions<br>▪ Immature equipment market | ▪ Currently in trial at Ameritech, Pacific Bell, and U S West<br>▪ Prices still hazy ($50 to $1,000/month) |

*Source: Forrester Research, Inc.*

- **Quality and timeliness will drop like a stone.** Lacking systems depth to handle their new role as wholesalers, local telcos will misplace orders and transfigure customer data as competitors pump thousands of requests into their systems monthly. Compounding the pain, continued layoffs will thin the ranks of experienced technicians and stress those still employed. Evidence of RBOC quality degradation is already apparent -- witness the recent multimillion dollar fines against NYNEX and U S West for failure to meet regulators' goals.

- **Local loop demand will outstrip supply.** As carriers acquire more traffic types from each customer site, the break-even for higher-speed dedicated access lines will be more easily met. Plus, as businesses increasingly use wide area networks to reach out to customers, demand for Internet access will soar (see the August, 1996 *Telecom Strategies Report*, "Sizing Internet Services"). But local telco plant upgrades will not keep pace with the surge.

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RESPONSES
BY
PETER W. HUBER
Senior Fellow, Manhattan Institute
Responses Submitted October 16, 1996

Hearing on "Mergers and Competition in the Telecommunications Industry"
Senate Judiciary Committee
Chairman: Senator Orrin G. Hatch
September 11, 1996

Senator Hatch's Questions

1. The most notable market trend during the next five years will be the bundling of all telecommunications services into a single package. By the year 2001, four or five companies will be selling one-stop, integrated, end-to-end phone service to end users in most major markets. AT&T, MCI, and Sprint will leverage their existing long-distance facilities and large customer bases by bundling down from their national long-distance networks into the heart of the local exchange, using both wireline and wireless technology. Every major wireless entity will be allied in some way with a favored long distance carrier, if only as a reseller. Every major long distance carrier will be linked in some way to a wireless carrier, either as an equity owner of facilities or as a reseller. Vertical integration will be the dominant trend in markets for information services and video too.

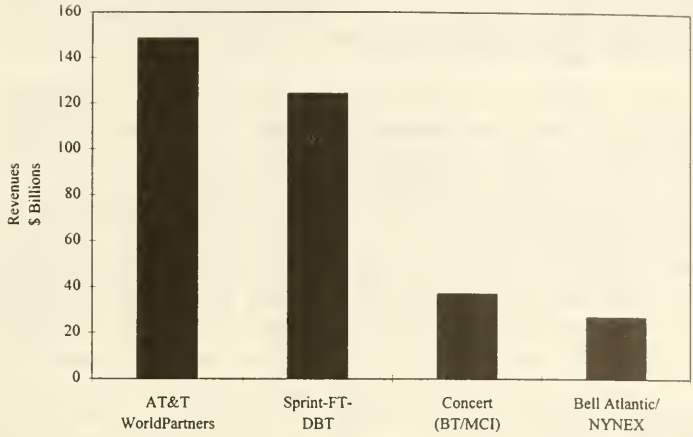
2. Past experience gives us some indication of how quickly markets are likely to grow. Output in markets for long-distance and wireless service, and for customer premises equipment, grew very rapidly after those markets were opened to competition. In long-distance, for example, AT&T's revenues and profits over the last decade have remained relatively stable, even as AT&T's market share has declined.

I believe there is little real possibility of the telecom industry growing more concentrated in the next few years. Even allowing for mergers, either already announced or that we can plausibly anticipate.

3. Telecom markets are going global. All major players in the industry are forging international alliances with very large players from abroad -- British Telecom, Deutsche Telecom, France Telecom, Canadian companies, and others. The Bell Atlantic/NYNEX and SBC/Pactel mergers will create entities that are capable of forming international alliances comparable to the ones already being built by AT&T, MCI, Sprint, and their partners from abroad. Figure 1.

Figure 1

International Alliances




4. The most likely competitors in the local exchange are those companies that already have facilities and a large customer base. These are primarily Competitive Access Providers (CAPs), cable companies and the largest long-distance carriers. Market analysts have stressed the importance of the "in-the-ground local networks (we call them 'desperately sought assets') to the success of the competitive local exchange carriers (CLECs)"[1] MFS, a leading CAP, has concluded that its local networks are "the right assets, at the right place, at the right time."[2] Cable companies have been described as "[t]he most obvious facility-based competitor[s]" in the local exchange due in part to their "extensive and relatively modern infrastructure of fiber optic and coaxial cable

[1] Reingold, D., et al, Merrill Lynch, Aug. 6, 1996, Rept. No 1770668. Merrill Lynch had earlier stated that "[i]t is clear that those potential local competitors who have more network facilities deeper into the network and who have to only lease commodity transmission from the Bells are clearly more likely to obtain a higher margin on their local business. Grubman, J.B., et al, Salomon Bros. Jan. 1, 1996 Rept. No. 1679303.

[2] MFS 1995 Annual Report (1996) p. 15.

in place."[3] Bob Allen, AT&T's CEO, explained how his company could quickly enter the local exchange as a facilities-based competitor: "Currently, a substantial number of the lines serving customers from AT&T's digital switching centers are directly connected to business customers' offices. . . AT&T need only make software adjustments and establish links to local switches in order to allow these direct connections -- now used only for long distance -- to handle local traffic as well."[4]

Many analysts, including market participants themselves, recognize that these national companies also possess marketing advantages over smaller, regional carriers. In its Annual Report, Sprint pointed to the advantages that the "national scope of the Sprint brand" gave it in the emerging marketplace.[5] Perhaps uniquely, AT&T benefits both from current and historical advertising; surveys have consistently shown that anywhere between 30 and 60 percent of the people in the U.S. still think AT&T is their local phone company.[6] A recent Yankee Group study found that almost 50 percent of the respondents said if they could get local and long distance service from the same carrier, they would select AT&T. Nobody else had more than a 6 percent share.[7] Robert Allen, AT&T's CEO, has predicted that his company "can win at least a third of [the local] market over the next 5 to 10 years."[8] In my view, these predictions are well within the realm of possibility.

An examination of state CLEC certifications confirms the importance of facilities, the ability to offer service bundles and an established user base. CAPs, with their in-place local networks, account for nearly 30 percent of the companies seeking local competitor status. Long-distance companies, which are

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[3] Robert A. Beizer and Emried D. Cole, Jr., When Local Exchange Competition Calls: A Survey of Competitive Local Exchange Access Issues.

[4] AT&T News Release, AT&T's Allen Outlines Plans to Enter Local Telephone Market, Feb. 8, 1996.

[5] Sprint 1995 Annual Report, Pg 5.

[6] Joseph P. Nacchio, Executive Vice President, Consumer and Small Business Division. Keeping the Customers Satisfied, speech before the Morgan Stanley Conference, New York, NY, Feb. 13, 1996. (http://www.att.com/news/speeches/96/960213.jna.html).

[7] Joseph P. Nacchio, Executive Vice President, Consumer and Small Business Division. Keeping the Customers Satisfied, speech before the Morgan Stanley Conference, New York, NY, Feb. 13, 1996. (http://www.att.com/news/speeches/96/960213.jna.html).

[8] Robert E. Allen, Chairman and CEO, AT&T, Remarks delivered at a news conference, Washington, D.C., February 8, 1996 (As prepared for delivery), http://www.att.com/news/speeches/96/960208.raa.html.

expected to bundle their existing offerings with their planned local services, make up roughly 20 percent of the companies seeking competitive entry. As a group, long-distance companies are ambitious in their geographic reach, accounting for nearly 30 percent of state certifications with the four national facilities-based carriers[9] accounting for over half of all long-distance carrier CLEC certifications.[10] Nearly 15 percent of new competitors are either cable or wireless companies. Tables 1 and 2.

| Table 1 | | |
|---|---|---|
| CLEC/CAP Companies | | |
| **Core Business** | **Number** | **Percent** |
| CAP | 61 | 29.5 |
| Long Distance | 44 | 21.3 |
| Wireless | 16 | 7.7 |
| Cable | 13 | 6.3 |
| LEC | 8 | 3.9 |
| Other | 65 | 31.4 |
| Total | 207 | |

| Table 2 | | |
|---|---|---|
| CLEC/CAP Certifications | | |
| **Core Business of Provider** | **Number** | **Percent** |
| CAP | 279 | 41.2 |
| Long Distance | 198 | 29.2 |
| Wireless | 51 | 7.5 |
| Cable | 54 | 8.0 |
| LEC | 12 | 1.8 |
| Other | 83 | 12.3 |
| Total | 677 | |

[9] AT&T, MCI, Sprint, and LDDS WorldCom.

[10] AT&T has received, or is seeking, CLEC status in all 50 states.

Senator Thurmond's Questions

1. I generally concur with the predictions made by long-distance carriers, CAPs, and cable concerns, about the prospects for local exchange competition. (See my earlier answers given in response to Senator Hatch.)

As to whether or not it is "certain" that robust competition will develop: No, nothing is ever certain in any free market, least of all a market in which technology is changing so quickly. But competition has increased and prospered in every other telecom market that has been opened to competition -- customer-premises equipment, central-office equipment, inside wiring, long-distance, wireless, on-line services, and so forth. I do not believe that the local exchange will be the one market in which competition fails.

2. As I indicated earlier, in response to Senator Hatch, the most notable trend during the next few years will be the bundling of previously separate services. Large, vertically integrated providers will serve the industry's main segments.

3. The final answer to this question depends not on what Bell Companies do or don't do, but on regulators. I would hope that Bell Companies not only meet the checklist but also succeed in persuading regulators and the courts that they have done so, within the next two years. But given the languid pace of regulatory review and legal challenges, delays are possible.

Senator Leahy's Questions

1. The 1996 Telecommunications Act contains provisions that specifically address the interplay between the antitrust laws and the FCC's regulatory responsibilities. The Act somewhat expanded the reach of the antitrust laws. It repealed section 221(a) of the Communications Act, which previously permitted local phone companies to merge without facing antitrust scrutiny if the FCC approved.[11] In other respects, the 1996 Act left existing antitrust laws unchanged.[12] All major telecom mergers will now go through standard Hart-Scott-Rodino review.[13] "[O]ne of the underlying themes of the bill," the conference statement declares, is to get both the FCC and the Department of Justice "back to their proper roles."[14]

There is no reason for the FCC or state regulators to attempt to reinvent or rewrite law so recently considered, and so overwhelmingly approved, by Congress. Congress could have created the linkage that your question suggests, in the 1996 Act. But Congress didn't.

2. The whole point of price cap regulation is to give phone companies the incentive to find creative new ways to make their operations more efficient. Well-conceived mergers are one way to create new efficiencies. It would be unconscionable for regulators suddenly to discover, long after a price-cap deal was put in place, that they didn't mean that kind of efficiency. Regulatory flip flops of that character would simply destroy the credibility of price-cap regulatory programs.

The most certain way to ensure that savings flow through to consumers is to step out of the way of competition. Competitive markets pass savings through to consumers. Over-regulated monopolies don't.

3. No. The mergers combine geographically discrete markets. The merging companies start with no share at all in the interLATA toll markets, either inside or outside their territories.

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[11] The Commission was empowered to immunize mergers from "any Act or Acts of Congress making the proposed transaction unlawful." Communications Act of 1934 § 221(a) (codified at 47 U.S.C. § 221(a)).

[12] Telecommunications Act of 1996 § 601(b)(1). ("Except as provided in paragraphs (2) and (3), nothing in this Act or the amendments made by this Act shall be construed to modify, impair or supersede the applicability of any antitrust laws.").

[13] 15 U.S.C.A. § 18a.

[14] Conference Report at 201.

RESPONSES OF ROBERT W. CRANDALL TO QUESTIONS FROM SENATOR HATCH

Answer 1. My testimony was that I cannot predict the future of the telecommunications industry for two years: (1) the current prices and service levels have been so distorted by regulation that they are not a very good basis for making predictions for an industry in which competition largely dictates prices and service levels; and (2) the rate of technical progress is so rapid that the mix of wireless and wireline technologies and corresponding services are very difficult to predict. Nevertheless, one might hazard a guess that in five years there will be far more wireless competition in all telecommunications services, but that switched broadband services over wireline companies may only be developing at that time. The key issue is whether the current local telephone companies, cable companies, long-distance companies, or other new entrants will build them. I cannot predict who the winner(s) will be.

Answer 2. The rate of growth of telecommunications will depend largely on the speed with which artificial regulatory structures prevent entry and keep the rates for price-sensitive services artificially high. If legal and regulatory battles over the implementation of the 1996 Act persist for several years, growth will be restrained. Otherwise, the growth in output could be considerably above 10 percent per year until an economic recession occurs. The market shares of large telecommunications companies will depend more on technology, regulation, and entrepreneurial abilities of the players than on the growth of the market. I am not concerned that we are likely to have highly concentrated markets if regulators indeed step aside and allow competition to work.

Answer 3. I do not think that mergers among large telecommunications carriers are required for these companies to compete in international markets or in other national markets.

Answer 4. At this point, I think that most of the competition in the next five years will come from wireless carriers, but I remind you of my answer to #1 above. Predictions in this sector are risky indeed.

Thank you for offering me the opportunity to share my view with you and your staff. I welcome any further questions that you may have.

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RESPONSES OF RON BINZ TO QUESTIONS FROM SENATOR HATCH

*Question 1.* One of the purposes of this hearing is for the Committee to take a "snapshot" of competition in the telecommunications industry today. Can you briefly project into the future and tell us what you think a snapshot of the industry will look like 5 years from now?

Answer 1. I believe that the future outlook for competition in the telecommunications industry is murky. Congress took great strides toward eliminating many of the legal barriers to competition in passing the Telecommunications Act of 1996. At this stage, however, it is uncertain whether the goals of that legislation will be achieved. The least competitive market in the telecommunications industry today is the market for local exchange telephone service. Whether competition develops for local telephone service in the next five years depends to a great extent on decisions to be made in the near future at the FCC, in state regulatory bodies and in the courts.

The markets for long distance service, telephone equipment, satellite services, and information services are relatively competitive today compared to the local telephone market, although none of these markets could be described as "perfectly competitive". The strength of competition in these markets in the next five years depends upon whether the major players in these industry sectors continue to consolidate.

*Question 2.* How rapidly do you believe the telecommunications industry will grow in the next five years? Is it possible that, even while these mergers will create larger entities, their market share in the telecommunications industry in fact will not grow appreciably in the coming years? What are the realistic possibilities that the telecommunications industry is becoming too concentrated?

Answer 2. As a whole, the telecommunications industry appears to be growing faster than the rest of the economy. Lower prices and services innovation, brought about in part by increasing competition, have stimulated tremendous growth in demand for telecommunications services. The telecommunications industry is likely to continue to grow over the next five years. In general, however, the market for local telephone service is growing at a slower pace than the rest of the telecommunications industry. For instance, the number of basic telephone lines provided by local telephone companies typically grows about 3–5% per year, while long distance usage tends to expand about 7–10% per year.

Whether mergers will lead to greater market share depends upon the particular merger and the particular market. The mergers of Bell Atlantic-NYNEX and SBC-

PacTel are not likely to lead to an increase in the market shares of these companies over local telephone service because, in the regions they serve, these companies have virtually 99% of this market already.

Whether the markets for telecommunications services become too concentrated depends largely upon whether new entrants are given the opportunities to compete. We are certain to see greater consolidation among the existing industry players over the next few years. This increasing concentration needs to be balanced by measures that allow innovators and entrepreneurs to enter these markets in order to protect consumers from monopolistic or oligopolistic behavior.

*Question 3.* How important do your think these mergers are to make American companies compete on a global basis?

Answer 3. I believe that the companies involved in the Bell Atlantic-NYNEX and SBC-PacTel mergers overstate the effect of these mergers on global competition. American firms, in general, are achieving significant success in foreign markets today. Almost every one of the Regional Bell Operating Companies has invested heavily in cellular and cable systems in Europe and Asia. The biggest hurdles facing many American corporations are trade barriers that keep American firms, both competitive firms and monopolies, out of foreign markets. Furthermore, it would be a dangerous policy for the United States to sacrifice the interests of American consumers by allowing domestic companies to strengthen their monopolies at home simply to gain advantages in overseas markets.

*Question 4.* Who do you think will be the most effective competitors in the local exchange market? How much market share do you think non-incumbent local exchange carriers will be able to gain?

Answer 4. It is too soon to know what companies will be the most effective competitors in the local exchange markets. Each of the potential competitors has advantages and disadvantages. Cable companies have wires to over 95% of American homes, but they do not have switching or two-way capabilities. Cellular and Personal Communications Services companies do not need to lay wires to every home, but they must construct and deploy thousands of antennas, and their spectrum does not yet provide them with enough capacity to serve large amounts of traffic. Long distance companies have a certain amount of name recognition, but they will need to use the facilities of the incumbent telephone companies for some time until they can build their own local networks. The virtue of the Telecommunications Act of 1996 is that it does not attempt to pick winners and losers but instead requires the regulators to enforce competitively neutral rules that will allow the most efficient providers to succeed.

More important than the question of market share is the question of market power. Market power depends upon many factors, including ease of competitive entry and price elasticity, in addition to market share. I believe that it will be quite some time before the incumbent local exchange companies lose their market power.

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RESPONSES OF RON BINZ TO QUESTIONS FROM SENATOR THURMOND

*Question 1.* Please state your views of concerns raised about whether effective local competition will ever develop for business and residential customers, despite the best efforts of the Congress. While many large companies are currently interested in entry, is it certain that robust local competition ultimately will be achieved?

Answer 1. No, it is not certain that robust local competition will be achieved, especially for residential customers. There is little doubt that consumers want competitive alternatives, but it is not clear whether competitors will be able to overcome the significant technical and regulatory hurdles that can impede their ability to enter the local markets. Whether robust local competition develops depends to a great extent on decisions that will be made by federal and state regulators over the next few years.

*Question 2.* As I stated in my opening statement, I am interested in views about how competition in local exchange and long distance services may develop over the next few years, and particularly your estimates of the number of likely competitors with substantial shares of those markets. Would each of you please comment?

Answer 2. The interstate long distance market is fairly competitive today, with over 400 regional and national carriers currently providing service. This market is likely to become more competitive in the future, as recent evidence shows that the smaller long distance companies are growing faster than the bigger carriers. The intrastate long distance market is less competitive, in part because many states do not yet require intraLATA toll dialing parity for instrastate service. The lack of intraLATA toll dialing parity gives a tremendous advantage to the Regional Bell Operating Companies over intraLATA toll calls. Once states permit intraLATA com-

petition, and permit intraLATA toll dialing parity, the intraLATA toll market is also likely to become more competitive.

The development of competition in the local exchange market is more problematic. Over the next five years, I believe that a number of cable companies, wireless companies, long distance companies, and resellers are likely to attempt to enter the local market. Whether they will be successful is hard to predict at this time.

*Question 3.* When do each of you expect the Bell companies to meet the statutory requirements and begin offering inter-LATA long distance service in the states in their own regions?

Answer 3. I understand that Ameritech is planning to file applications to provide interLATA service in at least two of its states before the end of this year, and that NYNEX may apply in one or two of its states early in 1997. Whether the carriers' plans to apply for interLATA service have changed as a result of the stay of the FCC's rules is too early to know. I believe, however, that the stay of the FCC's rules in the 8th Circuit Court of Appeals makes it much less likely that the FCC will have the statutory authority to approve these applications. Section 271 of the Telecommunications Act requires that RBOC to satisfy the "competitive checklist", which are, in part, determined by the FCC's rules. It will be difficult to know whether the RBOCs have complied with the FCC's rules until we know what the rules are.

Beyond this, there appears to be much work ahead of the RBOCs before their applications to provide interLATA service could be approved. The RBOCs must "fully implement" interconnection agreements that satisfy the 14-point competitive checklist, yet it is not clear that any of the RBOCs have done so at this time. Further, the RBOCs must face facilities-based competition from a competitor serving business and residential subscribers. I do not know of any residential consumer who has a choice of a competitive local exchange company today, much less a facilities-based competitor.

Finally, it is worth mentioning that whether the RBOCs are able to provide interLATA service inside their regions depends to a great extent on their own actions. The sooner the RBOCs unbundle their networks on a non-discriminatory basis, at cost-based rates, the sooner they will be able to provide interLATA service.

*Question 4.* Mr. Binz, you suggested in your written testimony that the Bell mergers should be conditioned on the Bells first satisfying the checklist found in Section 271 of the Telecommunications Act. In your view, who has the legal authority to impose such a requirement?

Answer 4. First, I would like to clarify that CPI believes the RBOCs should meet the competitive checklist not simply in one state, but in every state in which they are the incumbent provider of local exchange service today, before the mergers are approved. Regulators may also wish to condition their approval of the mergers on other consumer benefits, such as flowing through cost efficiencies of the mergers to consumers.

I believe that several parties have the legal authority to impose the competitive checklist as a precondition to approval of the mergers. The Department of Justice could enter into a settlement agreement with the RBOCs under which the Department would recommend that the court approve the mergers if the RBOCs agree to meet the checklist in each state. If no settlement is reached, the Department could bring an action under the antitrust laws, and the court hearing the case could decide on its own to require implementation of the checklist as a precondition to approving the mergers. The Federal Communications Commission, under its authority to enforce the broad "public interest" standard of the Communications Act, could require the checklist to be implemented before giving its approval. Some states, such as California, have broad statutory authority to consider measures such as the checklist requirement in the process of considering the mergers. Finally, of course, the U.S. Congress has the authority to impose such a condition.

*Question 5.* Mr. Binz and Mr. Hatfield, what is your response to the argument that there was no particular reason for initially dividing the Bell System into seven Bell operating companies instead of five, so there should be no objection now to the proposed consolidations?

Answer 5. At the time the court was considering the divestiture, the local exchange business was viewed as a natural monopoly. There was little expectation at the time that the market for local exchange telephone service could become competitive. Now that the local exchange market is on the verge of becoming competitive, there is little economic or policy sense to allow the incumbent local exchange companies to strengthen without taking countervailing measures to strengthen competitive opportunities.

RESPONSES OF RON BINZ TO QUESTIONS FROM SENATOR LEAHY

*Question 1.* Would conditioning approval of the pending mergers between the Bell Companies on those companies meeting the "competitive checklist" contained in the Telecommunications Act of 1996 for each of the States in which they operate today, help assure that resources continue to be directed first to opening up the local loop and then the mergers?

Answer 1. CPI has no desire to delay the mergers simply for the purposes of delay. CPI believes that the mergers threaten the growth of competition for local telephone service. This threat must be balanced by measures to promote competition. The idea behind the "checklist precondition" is to ensure that the RBOCs open the local loop to competition. The RBOCs should employ whatever resources are necessary to ensure that the checklist preconditions are met before the mergers are approved.

*Question 2.* Should regulators insist that operating efficiencies resulting from the mergers between the Bell Companies be passed along to ratepayers, particularly in those States with price cap regulation? If so, how can regulators ensure that ratepayers get the benefit of these cost savings?

Answer 2. Regulators should insist that an equitable share of the cost efficiencies from the mergers be flowed through to consumer in both rate of return and price cap States. These cost efficiencies can be flowed through in several ways, including rate refunds or reductions in future rates.

*Question 3.* Under the Telecommunications Act, the Justice Department has a major consultative role in the FCC's decision on a Bell Company's application for entry into the in-region long distance market, although the Department's comments "shall not have any preclusive effect" on that decision. [47 U.S.C. Section 271(d)(2)(A)]. Do you think the pending mergers between the Bell Companies, if approved, should have any effect on the Justice Department and FCC's evaluation of an application by one of the merged Bell Companies for entry into long distance service in their new combined territories? Could you explain why?

Answer 3. First, there is no question that both the Justice Department and the FCC have the legal authority to consider the effect of mergers on the Bell Companies' long distance applications. The legislation allows the Justice Department to evaluate the applications under any standard it believes is appropriate, and the FCC's public interest standard is very broad. CPI believes that the mergers increase the companies' ability and incentive to engage in anticompetitive activity against local exchange competitors. CPI thus believes that the mergers should be one of several factors that inform the views of the Department and the FCC when considering the companies' long distance applications.

## Additional Submissions for the Record

### Prepared Statement of Judy Brewer, Massachusetts Assistive Technology Partnership Center

Thank you for this opportunity to submit written testimony in the issue of "Mergers and Competition for the Telecommunications Industry."

As Project Director of the Massachusetts Assistive Technology Partnership (MATP) I am keenly aware of the benefits of technology for people with disabilities. I am also aware of the impact in the lives of people with disabilities when there are barriers to the use of technology, due to lack of vigilance in the design and development process. The MATP is one of 56 federally funded Tech Act Projects which promote increased access to assistive technology for people with disabilities through a variety of consumer-response, systems change activities including public awareness, information and referral, training, technical assistance, and particularly policy development and advocacy.

MATP staff have been active in areas of accessible information technology on the state and national levels. We have been active in advocating for accessible information kiosks; negotiating with Microsoft Corporation regarding the accessibility of its Windows 95 and Windows NT operating systems; working with the General Services Administration's Center for Information Technology Accommodation on the development of accessibility performance benchmark testing; serving on the National Council of Disability TechWatch Task Force, NYNEX's Consumer Advisory Panel for New England, and the Board of the Adaptive Environments Center, and serving as co-chair of the Compliance Subcommittee of the Telecommunications Access Advisory Committee, which is developing recommendations for the telecommunications equipment accessibility guidelines as required by Section 255 of the Telecommunications Act of 1996.

The disability community has become actively involved in the Telecommunications Act of 1996 regulatory proceedings and is watching with interest industry's post-legislation activities. In particular, being located in Massachusetts, our constituents are interested in the NYNEX and Bell Atlantic merger. The MATP looks to the NYNEX–Bell Atlantic merger as an opportunity for the "best access practices" of both companies to be combined in the new Bell Atlantic.

Over the years the MATP has worked closely with NYNEX on accessibility issues and we are pleased with its progress. NYNEX has taken a lead in making products and services accessible for people with disabilities. It is one of the first companies to adopt universal design principles which lay the groundwork for the development and deployment of accessible telecommunications. These principles state that NYNEX will (paraphrased):

> Provide quality services that can reasonably accommodate a broad range of diverse users, including individuals with disabilities;
>
> Review its existing services to determine which services should be made more accessible;
>
> Design and develop its services, to the extent readily achievable, so as to be accessible to a broad range of diverse users;
>
> Market and provide its services in a manner consistent with accessibility by a broad range of diverse users;
>
> Employ these universal design principles company-wide, in its relationships with customers, employees, shareholders and suppliers; and encourage companies related to but not controlled by NYNEX to adopt these principles.

NYNEX has established very active consumer advisory panels in New England and in New York. In Massachusetts, NYNEX established the Center for Individuals with Disabilities which administers the state-wide equipment distribution program. In addition NYNEX has taken the lead in closed captioning of all of its television advertisements.

NYNEX serves on the Telecommunications Access Advisory Committee under the Architectural and Transportation Barriers Compliance Board (Access Board), which will develop recommendations for guidelines for accessible telecommunications equipment and customers premises equipment.

The MATP would be supportive of a "new" Bell Atlantic which integrates NYNEX's present activities and commitment to accessible telecommunications products and services for people with disabilities which include:

The "new" Bell Atlantic's adoption and integration of the NYNEX universal design principles;

Support for the establishment of telecommunications equipment distribution programs in the "new" Bell Atlantic states;

Creation of universal design committees and consumer panels to provide essential consumer input;

Closed captioning of all "new" Bell Atlantic advertising;

An expansion of NYNEX and Bell Atlantic products and services which are already accessible and usable by people with disabilities.

There is an opportunity for the "new" Bell Atlantic to build on NYNEX's and Bell Atlantic's strengths, and to become the leader in accessible telecommunications for people with disabilities. The Massachusetts Assistive Technology Partnership looks forward to meeting with NYNEX and Bell Atlantic to discuss now we can work together to make this happen.

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## Prepared Statement of Dr. Barbara O'Connor, California State University, Department of Communications Studies

### SUMMARY

Mergers in the telecommunications industry are driven by technological advances and the removal of regulatory barriers that have hampered competition. They are, of themselves, neither good nor bad: they are a business-driven response to competition in an exploding industry.

Because mergers are subject to review by various federal and state agencies, however, mergers provide policy makers with an opportunity to promote the public interest. This interest will be well-served if the following points are taken into consideration:

Mergers allow two companies to combine resources and customer bases to gain broader efficiencies. These gains should lead to increased investment in advanced network infrastructure and the resulting introduction of new services at costs that are attractive to consumers.

The proposed mergers, between Bell Atlantic and NYNEX and between SBC and Pacific Telesis, are of particular interest to consumers. These companies represent the primary access point to the local switched network, and thus the "information superhighway," in the near-term future for the consumers in their regions. Because no other competitor has announced plans to launch a universal, facilities-based competitive drive for these customers, it is in the consumers' interest for these local exchange carriers to remain successful, competitive businesses.

New companies will adopt the best management practices of the merging partners; they should also adopt the best consumer and public interest practices of their former entities.

Given these points, policy makers should adopt two strategies when considering mergers in the telecommunications industry. First, they should do what they can to assure that merging companies adopt the best consumer and public interest practices of their merged partners. Second, they should encourage regulators to establish explicit service standards that any provider would have to meet and then follow through quickly and effectively on failures to meet those standards. This includes timely regulator responses to individual consumer complaints.

My name is Dr. Barbara O'Connor. I am a Professor of Communications at the California State University, Sacramento, where I also direct the Institute for the Study of Politics and Media. I am also the founding Chair of the Alliance for Public Technology, a nonprofit public interest group that promotes access to affordable and useful information and communications services and technologies for all people. Further, I am a member of the Federal Communications Commission's Network Reliability Council and a member of Bellcore's Advisory Board.

I have prepared this testimony to provide this Committee with a consumer perspective on mergers and competition within the telecommunications industry. Mergers are a natural outcome of the technological convergence among telecommuni-

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cations industries that we previously saw as distinct: television, cable, telephony, electronic online communications, etc. With digitization, these distinctions have blurred, and companies operating in one industry have naturally begun to look at the others as potential new marketplaces.

With the Telecommunications Act of 1996, Congress established a policy framework to allow competition to occur as freely and fairly as possible. They did so with the explicit expectation that consumers would benefit—from new services that would be universally available at affordable prices. They emphasized the importance of universality, and included special considerations for people with disabilities, low-income consumers, libraries, schools, and museums.

I do not believe that large corporate mergers, in and of themselves, are a threat to consumer interests. In fact, by improving efficiencies and combining the best practices of the merging firms, mergers can benefit consumers with lower prices, a wider array of services, and better programs for serving various consumers with special needs. Policy makers can help assure that these benefits are realized by:

Using their leverage, where possible, to make sure that the new companies adopt the best consumer and public interest practices of their merged partners; and

Encouraging regulators to establish explicit service standards and follow through quickly and effectively on failures to meet those standards.

*I. Mergers can benefit consumers*

Mergers of large telecommunications companies are driven by technological convergence—the fact that all kinds of messages can now be digitized—and by companies' attempts to protect their core markets while entering new markets. Mergers allow companies to combine their resources, attain efficiencies of scale and scope, and broaden their customer base. The Telecommunications Act of 1996 removed legal and regulatory barriers against entry into new lines of business, which gave further impetus to mergers. For example, the widely-respected Yankee Group described the proposed merger between Bell Atlantic and NYNEX this way:

"The New York-Washington, D.C. business corridor can essentially be viewed as a single marketplace, and the constraints on companies serving the telecommunications needs of this marketplace were artificially erected by regulation. Absent that regulation, a partnership between these two companies was an obvious step to capitalize on this market."[1]

In the proposed merger, Bell Atlantic and NYNEX estimate they will save at least $600 million dollars annually due to infrastructure consolidation and the initial reduction of 3,000 redundant management and administrative jobs.

These savings, and the merged companies' combined ability to attract financing, should allow them to keep prices affordable, and make significant new investment in infrastructure and in R&D. According to investment analyst Jeffrey Kagan of Kagan Telecom Associates in Marietta, Georgia, the merger could produce economies of scale that could translate into benefits for consumers.[2] As an example, the 1995 merger of Bell Atlantic and NYNEX's wireless operation brought a 21% reduction in cash expense per subscriber within one year, the lowest in the industry.[3]

Mergers can also benefit consumers by sharing the partners' complementary strengths. In the proposed merger between SBC and Pacific Telesis, for example, SBC customers could benefit from Pacific Telesis's leadership among the Bell Operating Companies in Internet services. Pacific Telesis will benefit from SBC's strong financial position following the decrease in their operating revenue from the spin-off of their cellular properties in 1994.[4]

These benefits are especially striking when one considers one of the outstanding consumer-related programs that could be expanded in the proposed mergers. Pacific Bell, for example, has a Telecommunications Consumer Advisory Panel (TCAP) that has become a very effective way for the company to stay in touch with California's diverse customer base. TCAP members include respected community leaders who give Pacific Bell input on various public policy decisions. The TCAP is also a vehicle for communication on telecommunications issues back to the consumer community in California. If the proposed merger between SBC and Pacific Telesis occurs, this program could benefit the consumer community in SBC's states if it is adopted and expanded by the new company.

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[1] Yankee Group, "Consumer Communications White Paper," v. 13, n. 12, April.

[2] Phil Waga, "NYNEX Merger: No Dollars for Dialers," Westchester Today, April 1996.

[3] Bell Atlantic News Release, "Bell Atlantic First Quarter Net Up 13.5 Percent," April 18, 1996.

[4] Yankee Group, "Consumer Communications White Paper," v. 13, n. 11, May 1996.

Similar opportunities exist in the proposed Bell Atlantic-NYNEX merger. The Massachusetts Assistive Technology Partnership Center, for example, has had a wonderfully productive relationship with NYNEX, resulting in NYNEX's adoption of "universal design" principles and a commitment to make their products and services accessible to all people, regardless of disability. This leadership should benefit the "new" Bell Atlantic's customers, as well. These examples help show why policy makers should do what they can to assure that such model programs are sustained and expanded when telecommunications companies merge.

*II. Some consumer concerns*

The major issue raised in policy circles by a merger is competition: is the merger anti-competitive? This concern is presented as a consumer concern, given that a reduction in competition would deprive consumers of competitions benefits. For this reason, mergers involving local exchange companies undergo extensive review by the Department of Justice. I am confident in that agency's ability to identify and resolve antitrust issues, just as it does in other industries.

Ironically, when I actually talk to consumers, their concerns are not focused on the issue of competition. They look, rather, at the specifies of their service: price and access to service, readability of their bills, service offering, customer service, the resolution of complaints, etc. In general, I think mergers can have positive effects on these elements. Price and access to service. Foremost for many consumers is the issue of price and access to service. In the case of merges involving local exchange carriers, this issue is confounded by the ongoing question of how the costs of the public telephone network should be allocated, regardless of a merger.

No matter what one's position on that question, people seem to agree that for the foreseeable future, the public telephone network operated by existing local exchange carriers will be the only universal infrastructure for access to telephone and data services for residences. Other companies that are planning facilities-based competition are focusing on high-density markets; they will not provide universal service in the near future. For this reason, it is paramount that local exchange carriers continue to be viable, competitive businesses; even their competitors rely on the existing local exchange infrastructure. If a merger makes business sense (for example, in the eyes of the business press and financial analysts), it can also make sense for the companies's customers.

There are so many factors that will affect the prices and availability of telecommunications services that we will never know for sure which is better for consumers: merged companies or independent companies. In this environment, it is vitally important that policy makers set standards for telecommunications providers, then focus their energies on assuring that those standards are met, not on mandating how they are met. In local exchange service, this means establishing an evolving definition of universal service, and setting up an equitable way for sustaining that level of service.

*Company responsiveness.*—Mergers sometimes raise consumers' concerns that the management of the merged telecommunications company will be further away, and thus less responsive to their needs. While this may have been a legitimate concern when companies first started consolidating and closing local branches, it has not been a significant factor in telecommunications for decades. When one lives in Buffalo, for example, it doesn't really matter whether the headquarters is in New York City or in Philadelphia; responsiveness is a matter of management performance, not distance.

Furthermore, the public system for resolving problems through states' consumer advocates and public utility commissions, remains the same after a merger.

*Service quality.*—Mergers also raise consumers' concerns about service quality. "Will the new company respond to my questions and concerns promptly? Will I get new services when they are introduced elsewhere? What if I have a complaint?" Although it is natural to be afraid of the unfamiliar, I believe that mergers actually promise to bring improvements in company operations, if anything. The merged company should adopt the best management practices of the merging parties, purely to maximize its business advantage. To fear that service quality will fall is to assume that maintaining high customer service standards is an unnecessary expense for businesses; anyone in the emerging competitive telecommunications industry knows that this is not true.

Consumer loyalty is a key competitive advantage as companies try to protect their core markets while entering new ones.

*III. Conclusion*

From a consumer perspective, the impact of a merger depends upon the particulars of the companies involved. Mergers can strengthen the merging partners, im-

proving their financial position, creating economies of scale, and increasing their customer base. These changes can lead to improved infrastructure, lower prices, and a wider array of services and public interest programs for consumers. These benefits are particular important when local exchange companies are involved in mergers, because local exchange networks will continue to be the only provider of universal access to telephone and data services for residences for many years to come.

Given these opportunities, policy makers should adapt two strategies as they consider mergers in the telecommunications industry. First, they should do what they can to assure that merging companies adopt the best consumer and public interest practices of their merged partners. Second, they should encourage regulators to establish explicit service standards that any provider would have to meet, and then follow through quickly and effectively on failures to meet those standards. This includes timely regulator responses to individual consumer complaints.

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MFS COMMUNICATIONS COMPANY, INC.,
*Omaha, NE, September 25, 1996.*

Hon. ORRIN G. HATCH,
*Chairman, Senate Judiciary Committee, Washington, DC.*

DEAR SENATOR HATCH: I wanted to respond for the record to testimony received at the September 11, 1996 Senate Judiciary Committee hearing on mergers in the telecommunications industry. During his oral statement, GTE's general counsel, William Barr, sought to make the point that incumbent local exchange carriers are already facing significant competition from new competitors. To support this claim Mr. Barr stated that MFS Communications Company, Inc. ("MFS") provided local telephone service to congressional offices and that Bell Atlantic, the local exchange carrier for Washington, D.C., did not. "This is a very profitable center here, Capital Hill * * *. The fact is, Bell Atlantic doesn't serve it. It was taken away by MFS". This statement is just flat wrong and the Committee should understand the facts.

MFS Communications Company is a leading provider of communication services for business. Through its operating companies, MFS provides a wide range of high quality voice, data and other enhanced services and systems specifically designed to meet the requirements of business and government customers. MFS is a publicly-held company and its common stock is traded on the Nasdaq National Market under the symbol MFST. MFS is headquartered in Omaha, Nebraska.

Contrary to Mr. Barr's averment, MFS is not the local service provider for Capital Hill. That service is in fact provided by Bell Atlantic. MFS provides no switched service in Washington, D.C. and has only recently been given a certificate to do so. MFS' subsidiary Metropolitan Fiber Systems of Washington, D.C., Inc. provides some limited private line service and also provides some access service to specific business and government customers but, as Mr. Barr should know, this is not local exchange service and certainly is no substitute for the comprehensive local services provided by Bell Atlantic.

MFS is proud to be one of the new competitors for local telephone service and we hope to grow into a significant alternative to companies such as Bell Atlantic and GTE but that will take time and a permissive regulatory environment. We believe the Telecommunications Act of 1996 and the FCC's interconnection rules create just such an environment and we look forward to offering true competition to incumbent local exchange carriers in the years to come.

We appreciate the opportunity to correct the record and hope that this letter will be included in the hearing record proximate to Mr. Barr's testimony.

Sincerely,

JAMES Q. CROWE,
*Chairman and Chief Executive Officer.*

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